

AR27

Phillips
Petroleum Company
Annual Report
1989

**ENERGY
AND THE ENVIRONMENT**

Corporate Profile

Phillips is headquartered in Bartlesville, Okla., where the company was founded in 1917. Bartlesville is located in northeastern Oklahoma, some 50 miles north of Tulsa.

Phillips is engaged in these businesses:

- Petroleum exploration and production on a worldwide scale.
- Petroleum refining and marketing in the United States.
- Chemicals production and distribution worldwide.

At year-end, Phillips employed 21,800 people, had 94,039 stockholders and assets of \$11 billion. The company's products and processes were licensed in 39 countries.

The Cover: Energy and the Environment

Now in its third decade as an environmental model, Phillips' Bridger Lake lease in Utah's Wasatch National Forest is proof that searching for energy and safeguarding the environment can go hand-in-hand. This year's cover shows blades of grass stretching through the crystal waters of Henry's Fork, a creek that makes its way through the 3,800-acre lease site. Production from Bridger was the first ever allowed in a national forest when it began in the middle 1960s.

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Despite lower earnings, Phillips further bolstered its capital structure in 1989 by paring debt and interest expense. Stockholders benefited from two dividend increases and realized a total return of 35 percent.	
Exploration & Production	5
Provides crude oil and natural gas later converted into refined products and chemicals. Is largest part of Phillips' business with assets of \$4.2 billion and 7,700 employees. Asset writedown led to lower 1989 earnings in spite of stronger operations.	
Gas & Gas Liquids	10
Gathers, processes and markets natural gas, extracts natural gas liquids, owns gas pipeline systems and manages coal operations. Provides gas liquids feedstocks for company refineries and chemical plants. Income increased fivefold in 1989.	
Petroleum Products	12
Includes Phillips' refineries and transportation/marketing of gasoline, propane and other petroleum products. Carries Phillips 66 banner through 10,000 service stations in 27 states. Higher feedstock costs triggered lower earnings in 1989.	
Chemicals	16
Upgrades gas liquids feedstocks into petrochemicals and plastics. Consistently ranks among industry's most profitable chemicals operations and is a major profit contributor for Phillips. Lower margins and an accident reduced 1989 results.	
Technology	20
Develops new products and production processes while improving existing ones. R&D started up new pilot plants and made further polymer advances during the year.	
Environment & Citizenship	22
Phillips formed a new environmental organization, helping set the stage for major environmental initiatives in the 1990s. Also made \$6 million in charitable donations and allocated 1.4 million shares to employee stock accounts.	
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In Memoriam

This report is dedicated to the memory of those who died as a result of an explosion and fire at the Houston Chemical Complex, Pasadena, Texas, October 23, 1989.

Phillips 66 employees

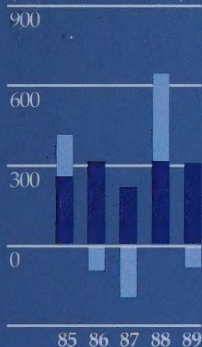
Ruben Q. Alamillo
James E. Allen
Albert E. Arce
James H. Campbell, Jr.
Eloy Gonzales
Mark L. Greeson
Jeffrey L. Harrison
Delbert L. Haskell
Scotty D. Hawkins
James D. Hubbard
Richard Leos
James A. Nichols
Jesse T. Northrup
Mary K. O'Connor
Gerald G. Pipher
Cipriano Rodriguez, Jr.
Jesse O. Trevino
Lino R. Trujillo
Nathan G. Warner

Contract employees

Jose Gonzalez
Juan Garcia
Scott Martin
John Medrano

Highlights

Net Income
(Millions of Dollars)



■ United States
■ Outside U.S.

	Millions of Dollars Except as Indicated		
	1989	1988	1987
Financial			
Total revenues	\$12,492	11,490	10,917
Net income	\$ 219	650	35
Net income from each dollar of revenue	1.8¢	5.7	.3
Net income per share of common stock	\$.90	2.72	.06
Writedown of offshore California investments (after-tax)	\$ 280	—	—
Interest expense	\$ 645	688	729
Total taxes charged to income	\$ 508	675	448
Capital expenditures	\$ 872	797	737
Total assets at year-end	\$11,256	11,968	12,111
Dividends paid			
Common	\$ 229	157	137
Preferred	\$ —	11	19
Cash dividends per share			
Common	\$.94	.66	.60
Preferred	\$ —	1.34	1.73
Average common shares outstanding (in thousands)	243,738	234,984	228,326
Common stockholders at year-end (in thousands)	94.0	96.9	100.1
Employees at year-end (in thousands)	21.8	21.0	22.5

	Thousands of Barrels Daily		
Operating			
Crude oil produced			
United States	102	110	113
Outside United States	116	112	105
Natural gas liquids produced	164	186	182
Total liquids produced	382	408	400
Crude oil refined	293	301	302
Petroleum products sold	588	585	555

	Millions of Cubic Feet Daily		
Natural gas produced	1,247	1,189	1,086

	Millions of Pounds		
Ethylene sales	501	720	903
Polyethylene sales	1,541	1,612	1,633

"Phillips," "the company," "we" and "our" are used interchangeably in this report to refer to the business of Phillips Petroleum Company and its consolidated subsidiaries. Where reference is made to a particular company, it is wholly owned unless otherwise stated. The company's consolidation policy is to include in financial statements the accounts of majority-owned, significant subsidiaries.

Alpha, Aspect, Crystalor, Driscopipe, K-Resin, Marlex, Phillips 66, Ryton, Supac and SuperClean are trademarks for the company's products named in this report.

Fellow Shareholders

As our cover suggests, energy development *can* take place in harmony with the environment. Achieving this harmony will be the greatest challenge we face as a company and as an industry in the 1990s. To have the public support needed in our business, we'll need to find more ways to reduce the environmental impact of our actions. And we'll have to gain better public understanding of what we do and why our work is vital to society.

Key events in 1989 show why:

■ In March, a tanker ran aground in Alaska. It spilled millions of gallons of crude oil in one of the nation's most scenic areas. This accident and other, smaller, spills during the year led many people to question our industry's competence and its ability to operate without harm to the environment. The spills also led Congress to set aside plans to consider opening additional public land, both onshore and offshore, for petroleum exploration.

■ Congress began consideration of a sweeping new Clean Air Act, legislation that would impose greater costs on society by restricting industrial activity and requiring consumers to change long-established patterns of behavior. Passage of this legislation will almost certainly require industry to make significant and costly changes in equipment, operations and products—changes that in some cases will have little environmental benefit.

■ And in August, an action by the California Coastal Commission blocked oil and gas production from the offshore Point Arguello field, the most significant oil discovery in the United States during the 1980s. More than \$2 billion has been invested by the industry in its development, and extraordinary safeguards have been put into place. Nevertheless, further activity has been halted by the determined opposition of several small groups of people who say they fear harm to the environment.

Phillips has a major interest in the Point Arguello field, and because of the regulatory stalemate, we felt it essential to reduce the value of our offshore California assets by \$423 million (\$280 million after taxes) in December. This writedown caused substantial negative results for the fourth quarter.

Our company and the petroleum industry as a whole can anticipate many more costs in the decade ahead that are directly related to the effort to conduct business in harmony with the environment. Managing those costs, improving our environmental performance, and rebuilding public trust and confidence will be essential to our success in the 1990s.

1989: Accomplishment and Tragedy

Our company's accomplishments in 1989, significant in many respects, were overshadowed by the tragic explosion and fire in October at the Houston Chemical Complex.

We mourn the loss of the 23 people killed in that explosion, and we extend, once again, our deep sympathy to their families and friends. We are still working to determine the cause of this accident, and we pledge to take every possible step to ensure that such an event can never take place again. Our plans for rebuilding our domestic polyethylene capacity are outlined on page 16.

During 1989, both the Point Arguello writedown and the Houston explosion had a negative impact on net income, which was \$219 million, or 90 cents a share, for the year, compared with \$650 million, or \$2.72 a share, in 1988. Without the writedown, our earnings for 1989 would have been \$499 million.

Higher worldwide oil prices and higher worldwide natural gas production in 1989 were beneficial to our exploration and production operations. But these gains were more than offset by lower earnings in our downstream businesses. Higher feedstock costs and operating expenses reduced profitability in refining and marketing. And earnings from chemicals declined significantly because of lower profit margins from plastics and lower olefins sales volumes. Our 1989 earnings were also affected by the loss of sales associated with the

Net Income Per Share
(Dollars per Common Share)



C. J. Silas

Profit From
Each Dollar of
Revenue
(Cents per Dollar)



Houston accident. The \$50 million deductible for our business interruption insurance was met in the fourth quarter.

A major positive development during the year was the further reduction of our total debt by \$869 million. At year-end, total debt was \$4 billion, down from a 1985 peak of \$8.6 billion, and we are looking into refinancing alternatives to reduce interest costs.

1990 and Beyond: Seeking Superior Value

Looking ahead to 1990 and beyond, we're encouraged by the outlook for stability in oil prices, and we plan to spend 20 percent more this year on exploration and production than in 1989. We will be active domestically, particularly in Alaska and the Gulf of Mexico, but we have shifted more emphasis overseas—to the North Sea, where we have extensive operations, and to Egypt, Nigeria and Indonesia. For several years, we have been building our acreage position in high-potential areas, and we will be drilling exploratory wells on key portions of this acreage in 1990. Much of our success in the future will depend on our ability to increase oil and gas production—as well as replacing the reserves that we produce, a goal we've met in each of the past three years.

We believe that natural gas will gain recognition as a premium fuel in the 1990s. We're drilling more wells and expanding production to take full advantage of our extensive supplies.

In our refining, marketing and chemical businesses, we intend to build on our strong integration; that is, our ability to convert the raw materials we produce into high-value products. With lower economic growth expected for the next year or two, our marketing objectives are to make and sell more premium fuel, to continue consolidating into our most profitable markets, and to increase the number of high-volume company-operated service stations.

We're active in the effort to develop cleaner-burning reformulated gasoline, and we plan to enter the retail propane market with a product that has strong potential as a cleaner-burning motor fuel.

Our chemicals business continues to grow, although profit margins have dropped recently from record levels. We expect further growth and are continuing to invest in areas where we have particular strength. We've started on a major expansion of ethylene capacity, and we're expanding production of our K-Resin specialty plastic resin and our polypropylene fibers and other products.

Our overall mission as a company remains unchanged: To enhance the value of your investment as a shareholder. Our shareholders realized a total return of 35 percent in 1989 and 44 percent the year before. In carrying out our mission, we remain dedicated to a safe working environment, high standards of ethical conduct and a constantly improving record of environmental performance.

We invite you to read the report that follows for a summary of our accomplishments in 1989 and a look at some of our plans for the years ahead.

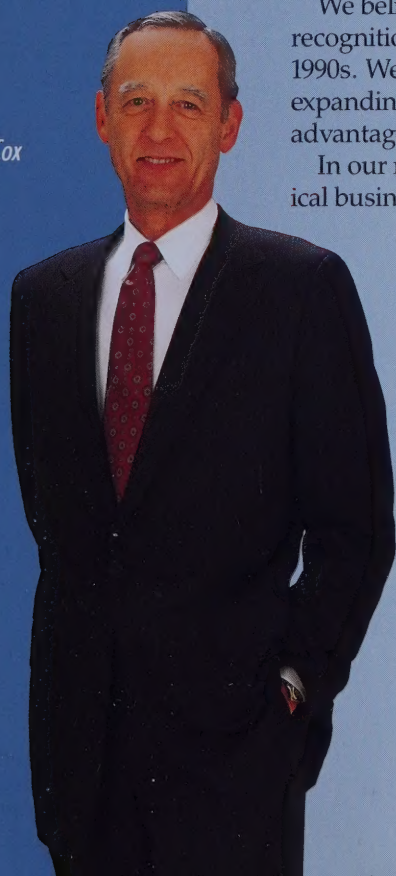
For the Board of Directors,

C. J. Silas
Chairman and Chief
Executive Officer

Glenn A. Cox
President and Chief
Operating Officer

March 12, 1990

Glenn A. Cox



Financial Summary

Phillips delivered value to stockholders in 1989 while continuing to strengthen its financial position. Total stockholder return was 35 percent; total debt was reduced by \$869 million. The company also refinanced debt in 1989, reducing interest costs.

A Commitment to Stockholder Value

Superior Total Return. Phillips is committed to providing shareholders with a competitive return on their investment through a combination of stock-price appreciation and dividend income. As a medium- and long-term objective, the company seeks to provide a total return to shareholders of some 15 percent a year, while consistently striving to rank among the oil industry leaders in shareholder return. Total return—stock-price appreciation plus dividends—was 35 percent in 1989, after being 44 percent in 1988.

Competitive Dividend Treatment. Phillips increased its quarterly common stock dividend on two occasions in 1989, from 18 to 22 cents a share in March, and to 25 cents a share in September. The two boosts represented a cumulative dividend increase of 39 percent.

In another step aimed at enhancing stockholder return, Phillips' board of directors late in the year authorized the repurchase of up to \$250 million of common stock by year-end 1990.

An Improving Financial Position

Debt Further Reduced. Total debt equaled about \$4 billion at year-end, a reduction of \$869 million during 1989. This put debt at well under half of its 1985 peak. As a result of such debt reduction, the company now plans to direct most of its cash flow to capital spending and shareholder distributions such as the announced stock buyback. At the same time, Phillips will continue to review refinancing opportunities in order to reduce interest expense.

Meanwhile, future principal payment obligations are modest, averaging about \$85 million a year over the period 1990-1992. Debt maturing in 1995—once \$2.3 billion—is now about \$450 million.

Long-term debt as a percent of total capital improved to 65 percent at year-end, from 69 percent at the end of 1988, based on the book value of stockholders' equity. Using the market value of Phillips stock as a basis, this ratio ended the year at about 40 percent.

Interest Expense Declining. Due to recent debt reductions, total interest expense on the company's debt declined by \$94 million in 1989.

In another move to reduce interest expense, Phillips is evaluating refinancing alternatives associated with \$2.3 billion of existing debt, callable in 1992, bearing an average interest rate of about 14 percent. Refinancing this amount at current interest rates could result in annual pretax savings of about \$100 million a year after 1991.

Sound Credit Ratings Secured. Phillips achieved a financial milestone in late 1988 and early 1989 when its debt was classified as investment grade by the major rating agencies. Such a rating recognizes the improvement in the company's credit-worthiness, which will result in more favorable terms for future borrowings and wider access to financial markets.

Phillips regards investment-grade ratings as a financial priority and intends to follow policies aimed at maintaining this status.

A Shifting Focus

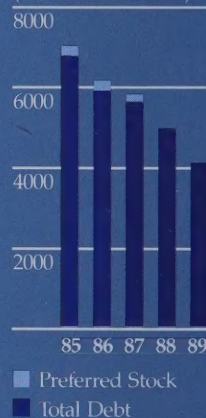
At this time, Phillips regards \$4.0-\$4.5 billion as a suitable debt range that allows a sufficient degree of financial flexibility. Thus it does not plan further debt reductions on a scale of recent years. Instead, capital expenditures and other programs designed to enhance stockholder value will stand as higher priorities.

The company's improved financial position also permits it to carry lower cash balances than before. Cash declined by \$371 million in 1989, to \$708 million at year-end. Phillips has secured committed credit sources if needed for investment opportunities or operating requirements.

Cash Flow From Operations
(Millions of Dollars)



Total Debt and Preferred Stock Balances at Year-End
(Millions of Dollars)



Cash Balances At Year-End*
(Millions of Dollars)

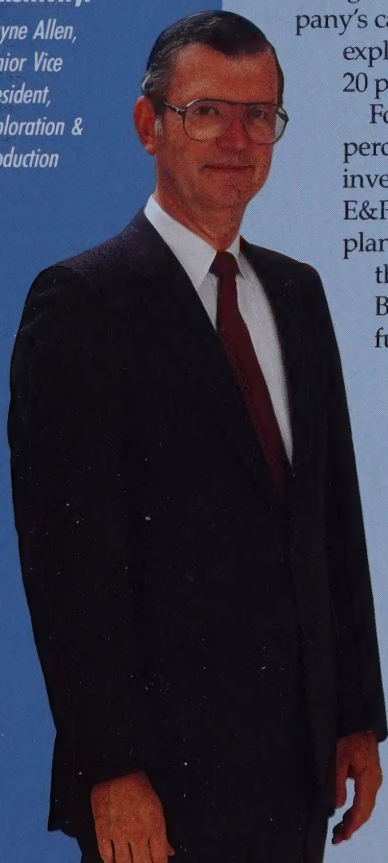


*Includes cash equivalents and short-term investments.

Exploration & Production

Phillips' environmental policy makes it clear that complying with the rules is not enough — we intend to take the initiative and become an environmental leader. That means looking to the future and staying ahead of new regulations that might be put into effect. As one example, we're moving quickly in E&P to remove asbestos from our U.S. facilities. The rules don't say we have to, but it's one way of demonstrating our environmental sensitivity.

Wayne Allen,
Senior Vice
President,
Exploration &
Production



Exploration & Production reported lower net income in 1989 as a result of the writedown of offshore California assets. Reserves were replaced for a third straight year and combined crude oil and natural gas production rose. Phillips made discoveries in seven countries.

Writedown Sends Profit Lower

Exploration & Production (E&P) net income for the year was \$102 million versus \$235 million in 1988. Of the decline, \$220 million was attributable to the writedown of offshore California investments arising from regulatory delays in starting production at the Point Arguello field.

Without this writedown, E&P earnings would have been \$322 million, an increase of 37 percent. Benefiting earnings were higher prices for crude oil coupled with higher natural gas production, partly offset by lower oil production and higher production and operating costs. Phillips' worldwide average crude oil price for 1989 was \$17.21 a barrel, up 22 percent. Worldwide gas prices averaged \$1.84 a thousand cubic feet, 2 percent lower than in 1988.

Capital Expenditures Up 20 Percent

During the year, \$451 million of the company's capital expenditures was directed to exploration and production efforts, 20 percent more than in 1988.

For 1990, Phillips plans to devote 46 percent of its capital expenditure and investment budget, or \$550 million, to E&P projects. Major expenditures are planned for development programs in the Gulf of Mexico and San Juan Basin (New Mexico), as well as for further expansion of the Ekofisk field waterflood and for development projects in the U.K. North Sea, Nigeria and Indonesia. A significant increase in frontier exploration is planned.

Crude Oil Production Down, Gas Up

Production of crude oil for the year was down 2 percent mainly because of the natural decline in U.S. fields. However, natural

gas production rose 5 percent. Combined oil and gas production was up slightly.

Natural gas production rose as a result of various U.S. development projects plus higher production from U.K. fields.

Secure Production, Reserves Among Key Strengths

Competitive strengths include reserves and production concentrated in secure parts of the world, favorable finding and development costs and a good balance between oil and natural gas reserves. Forty-seven percent of Phillips' crude oil production and 70 percent of natural gas production came from the United States in 1989. On a barrel-of-oil-equivalent basis, the U.S. accounted for 56 percent of Phillips' total proved reserves at year-end. In addition, Phillips is rich in reserves of natural gas, largely in the United States. At year-end, gas equaled 48 percent of Phillips' total reserves and 57 percent of domestic reserves.

Reserves Replacement, Wave Barrier Year's Leading Events

Reserves Replaced. In 1989, Phillips replaced 124 percent of its worldwide reserves produced during the year on a barrel-equivalent basis. Total worldwide proved reserves on a barrel-equivalent basis were 1.90 billion barrels at year-end, an increase of 2 percent. About 40 percent of the increase was due to extensions and discoveries, the rest being from enhanced recovery and revisions. Crude oil reserves rose 5 percent and natural gas reserves fell 1 percent; natural gas liquids reserves ended the year 4 percent higher.

Domestic reserves replacement performance was particularly strong. Aided by discoveries in the Gulf of Mexico, Texas Panhandle and California, Phillips replaced 148 percent of its domestic production, versus 89 percent in 1988. Domestic reserves were up 5 percent for the year; foreign reserves declined 1 percent.

Ekofisk Wave Barrier Installed. Phillips in 1989 completed the last phase of a project to overcome the effects of subsidence at the Ekofisk field, by installing a giant wave barrier around the field's storage tank facilities. The barrier will shield equipment in the tank area from high waves.

Exploration Venture Formed. During the year, the company entered into a joint-venture agreement with companies from Taiwan and Korea that calls for drilling some 100 prospects in the United States through 1991. The venture is expected to roughly double the number of U.S. wells the company otherwise would drill.

The two foreign companies agreed to put up 80 percent of the project's funding in exchange for a combined 40 percent interest in any production that might result.

During the year, Phillips made three commercial discoveries on acreage dedicated to the joint venture, resulting from 15 wells. About 30 more wells are planned for 1990.

California Production on Hold. Production from the Point Arguello field, offshore California, was delayed because of problems securing regulatory approval. In the spring, the Santa Barbara County government agreed to allow production to begin, but that decision was later overturned. Phillips and its co-venturers are appealing the decision.

Discoveries Made in Seven Countries. During the year, Phillips took part in discoveries in seven countries—the United States, Argentina, Canada, Egypt, Nigeria, Norway and the United Kingdom. The largest discovery was made in the Gulf of Mexico, at the South Marsh Island field, where the company holds a 100 percent interest.

In addition, Phillips acquired acreage in nine countries, while increasing its worldwide acreage position by 27 percent. The largest accumulation of acreage—3.6 million net acres—was in Somalia, located in East Africa.

North America: Large Discoveries in Gulf, California

Gulf of Mexico. The company continued an active program in the Gulf during 1989, participating in 24 exploratory wells, including 12 discoveries, while acquiring 107,000 net acres in federal lease sales. The company plans to participate in 21 exploratory wells in the Gulf of Mexico in 1990.

Early in the year, the company made one of its largest domestic discoveries in recent years at the South Marsh Island field, 90 miles offshore Louisiana. Production is slated to begin in late 1990, reaching an

average daily rate of 72 million cubic feet of gas and 4,000 barrels of oil in 1991.

California. Early in the year, Phillips made a large gas discovery in Kern County, California. The discovery resulted in the drilling of additional wells and benefits from being near available gas markets. Net production equaled 7.5 million cubic feet a day at year-end and is expected to rise in 1990.

Alaska. At year-end, Phillips was taking part in an exploratory well being drilled in the Camden Bay region, off Alaska's North Slope, where the company acquired 45,000 acres. In state lease sales, Phillips acquired 15,000 acres in the Simpson Canyon area, about 150 miles west of Prudhoe Bay.

Core Basins. Additionally, Phillips continued with an extensive development program at the Carlander field in Sherman County, Texas, and in the North Louisiana/East Texas area where 25 more wells were completed in 1989, resulting in net gas production of 91 million cubic feet a day.

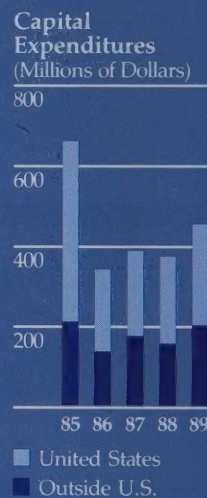
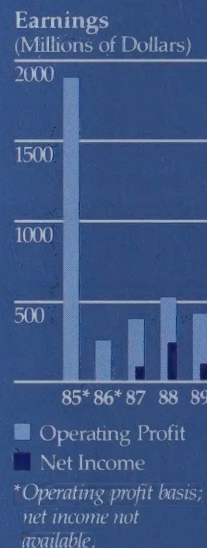
Also in 1989, the company entered into an agreement giving it a majority working interest in 111,000 acres of the San Juan Basin in northwestern New Mexico. The area is rich in coal seam methane gas as well as conventional gas. The company plans to drill about 100 wells in the area during 1990, likely resulting in significant gas production.

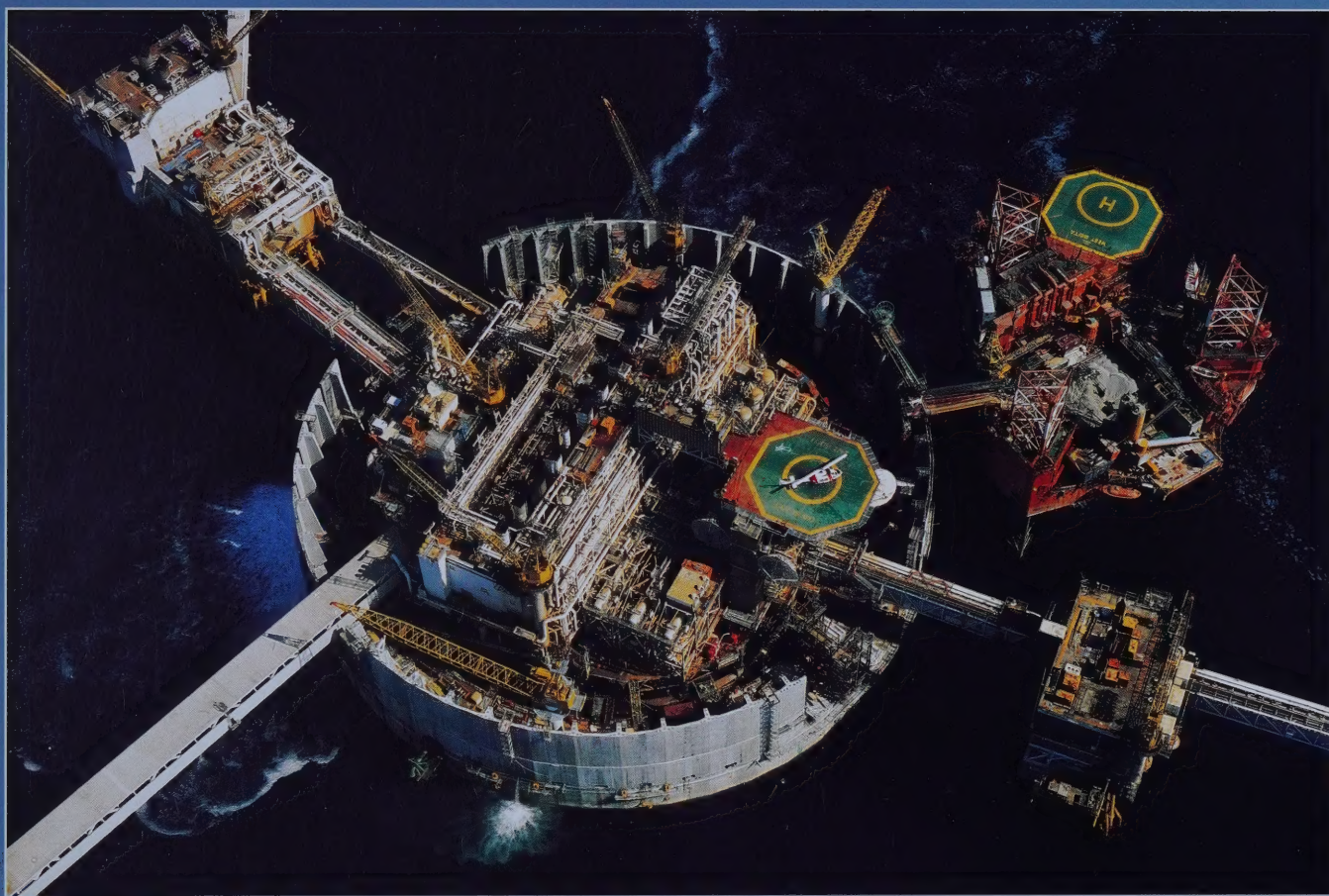
Enhanced Recovery. Some 365 secondary and tertiary enhanced oil recovery projects were operating at year-end, accounting for about one-third of Phillips' U.S. crude oil production.

Seven enhanced recovery projects in the Permian Basin area of western Texas and eastern New Mexico got under way in 1989. They are expected to increase production by about 5,000 barrels a day, or 34 percent, over the area's base production by the mid-1990s.

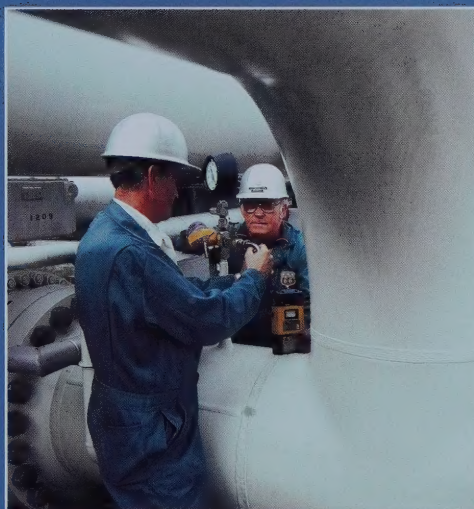
International: Norway Production Up, Audrey Expansion in Works

Norway. Phillips' share of crude oil production from the seven-field Greater Ekofisk Development, located in the Norwegian North Sea, rose by 9,000 barrels a day. The year's increase came as a result of a water-flood project and various development activities.





Ekofisk operations were little affected by installation of a massive circular wave barrier, above, that protects key structures from storm damage. Aided by a waterflood project, Phillips' oil production from Greater Ekofisk has climbed 44 percent since 1987.



Workers at England's Bacton gas plant check equipment that helps receive production from Phillips' offshore Hewett and Della fields. Hewett — the company's original source of U.K. gas — marked its twentieth anniversary of production in 1989.

The Ekofisk waterflood, begun in 1987, became fully operational during the year. Oil production from the area involved in the project rose by about 40 percent. Because of the waterflood's success, Phillips is expanding the project to the south edge of the Ekofisk field.

During the year, an oil discovery was made on a newly acquired block located northwest of the Ekofisk complex. The structure was being evaluated at year-end. Likewise, results of an appraisal well drilled at the South Eldfisk field, site of a 1988 oil discovery, were under evaluation.

United Kingdom. U.K. gas production rose 51 percent, reflecting a full year's addition of gas produced from the Audrey and Della fields.

During the year, Phillips announced a program to expand production at Audrey by adding a second unmanned platform. The project, which is expected to be complete in late 1990, will increase net production by some 14 million cubic feet a day.

Crude oil production from the Maureen field fell 16 percent because of the natural decline. During the year, the company received government approval to develop the Moira field as a satellite to Maureen. Initial production of some 1,800 net barrels of oil a day is expected in 1990.

Also in 1989, Phillips completed a ninth appraisal well in the J-Block's Judy field and completed appraisal of the Maggie prospect. Meanwhile, appraisal drilling proceeded at the Alba field, about 20 miles west of Maureen in the U.K. North Sea.

Nigeria. Crude oil production increased 7 percent (to 21,300 barrels a day) from Nigeria, where a production curtailment remained in effect. Phillips took part in a significant oil discovery made during the year at Ogbainbiri, with appraisal drilling set for 1990. Also, engineering studies and sales agreements are expected to be finalized in 1990 for a new natural gas liquids plant near Port Harcourt, in which Phillips would have a 20 percent interest.

Other Africa. Phillips continued to expand its presence in other parts of Africa, by participating in two discoveries in Egypt's South Umbarka field and acquiring some 4 million additional acres in Africa during the year.

The company's first exploratory well in Somalia was being drilled at year-end. In addition, Phillips picked up a 100 percent interest in 3.6 million acres with the signing of an exploration contract late in the year. Also, an exploratory well in the West African nation of Gabon is scheduled to be drilled in late 1990.

Australia. Early in 1990, Phillips acquired a 25 percent interest in Australia's Harriet field, which is expected to contribute some 2,500 barrels of oil a day to production during the year.

Indonesia. Production facilities for a second field in Indonesia's Kakap block were installed during the year, in anticipation of production reaching about 3,800 barrels of oil a day by the end of 1990.

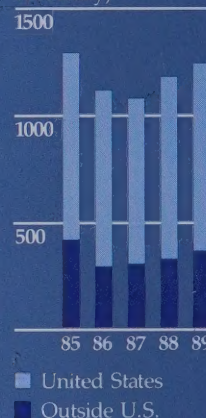
In other areas, Phillips in 1989 acquired exploration acreage in Papua New Guinea, began developing a gas field in the Netherlands and readied plans for appraisal drilling offshore China, scheduled in 1990.

E&P Strategies: A Balanced Slate

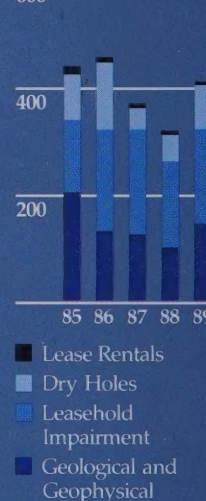
E&P has developed near- and long-term strategies to help meet its objectives of increasing reserves and profit. Near-term strategies center around development of existing discoveries that can be brought onstream quickly and provide cash flow in a short time. These strategies, in addition, provide for the development of promising prospects that could lead to production in the next five or so years. Included are areas where discoveries have been made but appraisal is still in progress, such as South Eldfisk and J-Block, both in the North Sea.

Longer term, E&P is pursuing a balanced exploration program including new focus on frontier prospects, mainly overseas, with large reserves potential. About 60 percent of the company's 1990 exploration budget is being directed to foreign projects, compared with 43 percent in 1989.

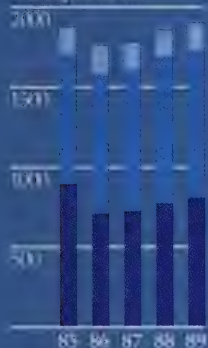
Net Natural Gas Production
(Millions of Cubic Feet Daily)



Exploration Expenses
(Millions of Dollars)

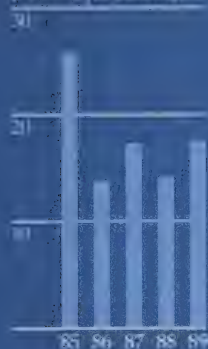


Worldwide Proved Reserves
(Millions of Barrel-
Oil-Equivalent)

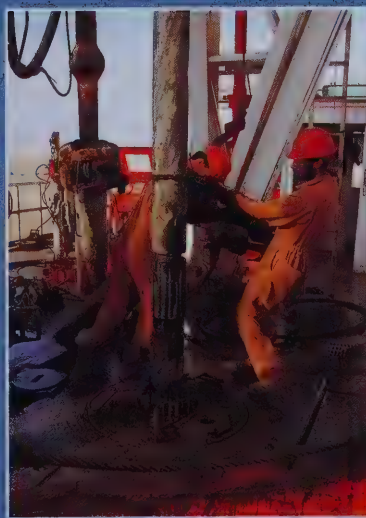


■ Natural Gas
Liquids
□ Natural Gas
■ Crude Oil

Average
Worldwide Crude
Oil Sales Price
(Dollars per Barrel)



Texas' Carlander field, above, is a prime example of Phillips' success in core areas of the U.S. The field, which came onstream in 1988, had daily net production of 2.5 million cubic feet of gas and 1,800 barrels of crude oil in 1989.



Left, an indication of the company's growing interest in frontier exploration, this well is being drilled at Egypt's South Umbarka field. Phillips plans to spend some 35 percent more on foreign exploration in 1990 than the previous year.

Gas & Gas Liquids

Gas & Gas Liquids' net income rose to \$50 million in 1989, compared with \$9 million a year earlier. The increase was due to higher residue gas and natural gas liquids sales prices and slightly higher residue gas volumes as well as lower costs. These factors were partly offset by lower natural gas liquids and methanol sales volumes.

Phillips will devote about 6 percent of its 1990 capital expenditure and investment budget, or \$69 million, to Gas & Gas Liquids (G&GL). Expenditures will be made to connect new gas supplies to the company's gathering and processing systems and to make initial payments on two LNG (liquefied natural gas) tankers under construction. Capital spending in 1989 primarily went for connecting new gas supplies.

Strengths: Extensive Supplies, Well-Situated Gathering Systems

G&GL competitive strengths include extensive natural gas supplies, well-situated gathering systems and efficient processing centers. In addition, Phillips remains the nation's largest producer of natural gas liquids. Another strength is that Phillips sells a high proportion of gas directly to premium end-use markets. Phillips also is well-established in the LNG business, having made deliveries to major Japanese utilities for more than 20 years.

1989 Highlights: Asset Consolidation, More Direct Sales

Asset Consolidation Continuing. In moves to improve efficiency and consolidate assets, two gas plants were shut down during the year and agreements were made to route gas formerly processed by other companies to Phillips' gas plants.

Direct Sales Showing Growth. Residue gas sales made directly to end-users such as utilities grew to about 60 percent of the total during the year, versus about 45 percent for 1988. Direct sales are typically more profitable than other marketing alternatives.

Gas Purchase Agreements Restructured. In addition, the company completed a two-year program to renegotiate gas purchase

contracts on a so-called "percent of proceeds" basis. This arrangement links the price paid for producers' gas to market prices for gas liquids and residue gas. Some three-fourths of Phillips' gas purchase volumes are now covered by this or a similar-type sharing agreement.

Natural Gas Supplies Lower. In addition to natural gas from its own exploration and production program, Phillips has access to extensive supplies of natural gas and natural gas liquids through purchase contracts and processing agreements. G&GL buys about 80 percent of its natural gas supplies from third-party producers.

At year-end 1989, natural gas estimated available through outside purchase contracts and agreements totaled 3.20 trillion cubic feet, versus 3.53 trillion cubic feet at year-end 1988. Corresponding figures for gas liquids were 434 million barrels at the end of 1989 and 452 million barrels the prior year.

Strategies: Increase Gas Volumes, Achieve Efficiency Improvements

G&GL plans to continue seeking additional gas supplies by making new well connections and consolidating collection systems with other companies. The group also remains committed to further streamlining and further gains in direct gas sales to end-users, as well as to adding more pipeline sales outlets and storage capacity.

Coal Production Under Way

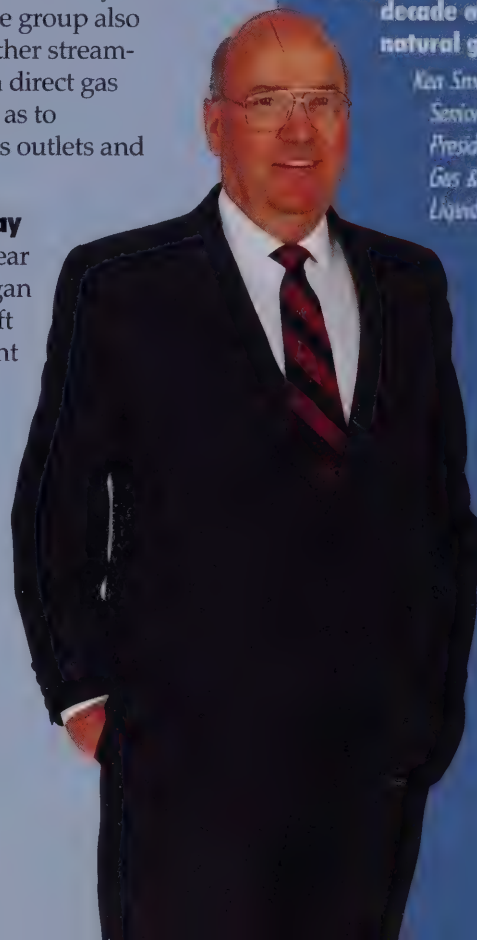
During the year, a mine near Coushatta, Louisiana, began production of lignite, a soft coal suitable as power plant boiler fuel. Production is scheduled to get under way in 1990 from a lignite mine in Texas and from a subbituminous coal mine in Wyoming. Total production is expected to reach about 2 million tons in 1990, increasing to some 6.5 million tons by 1993.

Capital Expenditures (Millions of Dollars)
1981



Natural gas may be the closest thing to a perfect hydrocarbon fuel. It burns cleaner than many other fuels and there's plenty of it here in our own country. If this is the decade of the environment, it could also be the decade of natural gas.

*Ken Smalley,
Senior Vice
President,
Gas & Gas
Liquids*



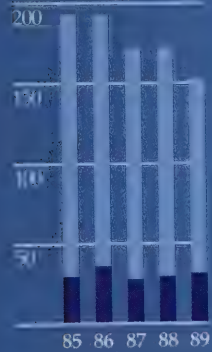
Earnings (Millions of Dollars)



■ Operating Profit
■ Net Income

*Operating profit basis;
net income not
available

U.S. Net NGL Plant Production (Thousands of Barrels Daily)

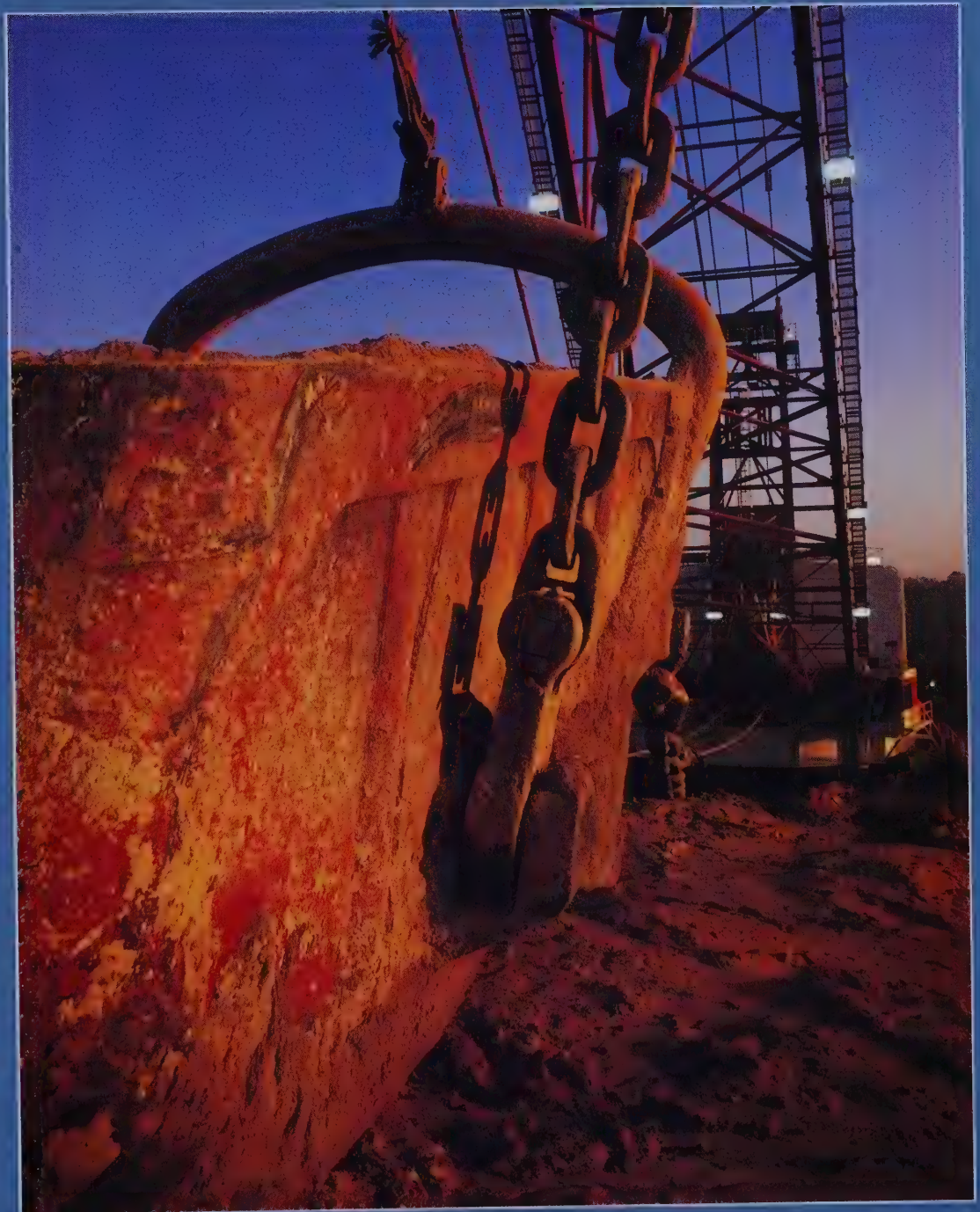


■ From Purchased Gas
■ From Leasehold Gas

U.S. Natural Gas Sales (Millions of Cubic Feet Daily)



■ Residue Gas
■ Liquefied Natural Gas



This dragline — coal's version of a drill bit — pauses after chewing through the topsoil, or overburden, at a Louisiana lignite mine opened during the year. Phillips is one of the nation's largest non-utility holders of lignite reserves.

Petroleum Products

Petroleum Products had lower profit in 1989 as a result of higher costs and lower refining volumes. The company continued an image improvement program at Phillips 66 stations. A new alkylation unit to boost output of high-octane gasolines came onstream at Sweeny.

Higher Costs Squeeze Profit

Net income for Petroleum Products was \$176 million in 1989, compared with \$312 million a year earlier. Margins narrowed as higher costs, primarily for feedstocks, could not be fully recovered by higher sales prices. U. S. sales volumes of most refined products were lower.

About 21 percent of Phillips' 1990 capital expenditure and investment budget, or \$248 million, will go to Petroleum Products.

Future downstream investments are certain to be dominated by more stringent environmental regulations. Late in 1989, Phillips authorized engineering design of a large-scale methyl tertiary butyl ether (MTBE) project, which could lead to higher production of pollution-reducing octane boosters. Further, the company in 1990 is expected to authorize projects to produce cleaner-burning, low-sulfur diesel fuels and to begin, on a limited scale, retail marketing of propane for vehicle fueling. Phillips also is active in industry research programs on reformulated gasolines.

Secure Feedstocks, Sophisticated Refineries

Phillips has access to secure sources of feedstocks for its refineries and other downstream operations. Some 71 percent of the crude oil processed by Phillips' refineries in 1989 came from the United States, much of it from the company's own operations. Company refineries, moreover, are engineered for profit—running a high share of less expensive, high-sulfur crude oil and generating a high percentage of products such as gasoline and petrochemicals at the upper end of the value range. High-sulfur crude oil accounted for 73 percent of Phillips' refinery runs in 1989, about the same as the previous year.

Highlights: Refinery Runs, Brand Image Program Strong

Retail Sales Gaining Ground. Although the company's U.S. gasoline sales volumes showed little growth in 1989, coinciding with the industry as a whole, volumes from company-operated, retail outlets increased by 11 percent. Branded volumes sold to independent marketers dipped 2 percent as Phillips took steps to withdraw marketing operations from four states and concentrate on its more profitable regions. The number of Phillips 66 marketing outlets at year-end was about 10,000, a decline of 1,100. U.S. sales volumes of distillates—diesel fuel and fuel oil—were down 4 percent. Natural gas liquids sales volumes declined 11 percent as low prices limited supply.

Refineries Running at High Level.

Although Phillips' refineries ran at a lower rate in 1989, they still were able to operate at 96 percent of their rated capacity, compared with an industry average of 86 percent. Crude runs were 293,000 barrels a day, down 3 percent due to greater downtime for repairs and maintenance. Refinery runs at the Borger, Texas, refinery reached a record high.

Phillips' refineries also processed 172,000 barrels of natural gas liquids a day, down 14 percent from 1988.

Brand Image Program in High Gear.

Phillips continued to strengthen its brand image by adding 27 company-operated, retail stations, mainly in high-traffic, urban areas. In addition, some 300 more Phillips 66 stations owned by independent marketers were upgraded to meet the company's exacting image and appearance standards. Phillips also is making investments to upgrade its marketing infrastructure by building and renovating product terminals and pipelines.

Downstream operations are on the front lines of today's environmental movement. In the next few years we'll see changes in motor fuel, plus continued emphasis on reducing emissions and waste. Phillips is in good position to respond to this environmental emphasis. We have versatile refineries, and we've been quick to get involved in industry research programs on new gasolines. Phillips is serious about the environment, and we intend to be an environmental leader.

BW Thompson,
Executive Vice
President,
Downstream
Operations





Shining above White Bear Lake in St. Paul, Minnesota, the Phillips 66 station above is part of a rapidly growing fleet of company-operated stations that are industry leaders in per-unit gasoline sales volumes. In 1989, the number of such outlets increased by 12 percent, to 260.



Left, Phillips' premium-services Executive Card attracted more than 100,000 accounts after being introduced in 1989. The card offers services such as travel discounts and insurance in return for an annual fee. Overall credit sales at Phillips stations rose 8 percent during the year to a record level.

Refineries Adapting to Environmental Rules.

Faced with tighter standards on gasoline emissions, Phillips in 1989 stopped producing leaded motor fuel at the Sweeny refinery and plans to discontinue leaded fuel entirely in 1990. Also, during the summer months, company refineries cut back on the use of butane as an octane booster in response to new environmental rules. In light of this seasonal curtailment, Phillips authorized engineering work for a large-scale MTBE unit at the Borger refinery. The MTBE process combines butane-derived isobutylene with alcohol, creating a cleaner-burning, high-octane gasoline component.

Strategies: Expand Retail Marketing, Enhance Product Quality

Expand Company-Retail Marketing. Phillips remains committed to increasing gasoline sales through company-operated, retail service stations. Retail outlets accounted for less than 3 percent of Phillips 66 outlets in 1989 yet generated 13 percent of company gasoline sales. Volumes sold through company-operated stations have more than tripled since 1984. Phillips is planning to build 40 to 50 new retail outlets annually in the next few years.

In a sign of commitment to cleaner-burning motor fuels, Phillips in 1990 intends to begin retail-marketing of propane as a vehicle fuel. By entering the retail market, the company plans to build on its longtime record as a major propane wholesaler.

Produce More High-Value Products.

Phillips continued making improvements to its refining system to allow for greater production of high-value products such as mid-grade and premium gasoline. A new HF alkylation unit at the Sweeny refinery went into operation in 1989, increasing production capacity of high-octane fuels by about 5,000 barrels a day. Additional investments are planned to improve octane capability and produce cleaner-burning, low-sulfur diesel fuel.

Score Further Advances in Product Quality.

In a further effort to build customer support, Phillips in 1989 introduced a new gasoline additive offering superior cleaning power for intake valves and port fuel injectors. All grades of Phillips SuperClean unleaded gasolines will contain this additive as it becomes available throughout the company's marketing region in early 1990.

Improved product quality in Phillips' view also extends to finding ways to produce more environmentally acceptable fuels and to the company's initiatives with respect to propane motor fueling and research on cleaner-burning, reformulated gasolines.

Refinery Crude Oil and Natural Gas Liquids Capacities And Runs—Thousands of Barrels Daily

	Crude Oil		Natural Gas Liquids	
	Capacity	Runs	Capacity	Processed
1989				
Sweeny, Texas	175	167	90	77
Borger, Texas	105	104	95	76
Woods Cross, Utah	25	22	—	—
Conway, Kansas	—	—	42	19
	305	293	227	172
1988				
Sweeny, Texas	175	175	90	90
Borger, Texas	105	102	95	82
Woods Cross, Utah	25	24	—	—
Conway, Kansas	—	—	42	28
	305	301	227	200

Major Products Produced Per Barrel of Crude Runs

	1989	1988
Automotive gasoline	60%	61
Aviation fuels	12	13
Distillates	28	28
Residual products	2	2

Phillips blends natural gas liquids into automotive gasoline, resulting in one of the industry's highest percentages of gasoline produced per barrel of crude oil runs.

Earnings (Millions of Dollars)



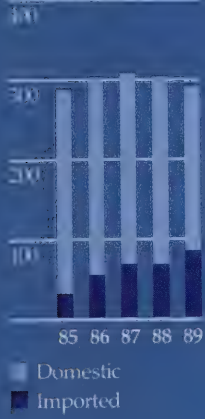
Capital Expenditures (Millions of Dollars)



Refinery Crude Oil Runs (Thousands of Barrels Daily)



Refinery Crude Oil Runs (Thousands of Barrels Daily)

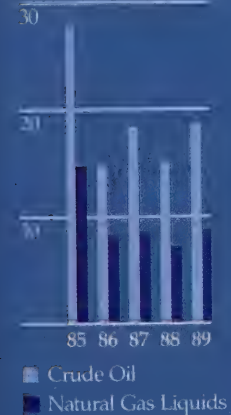


Crude Oil and NGL Capacity And Runs (Thousands of Barrels Daily)



Crude Oil Runs Capacity Natural Gas Liquids Runs Capacity

Average Cost of Refinery Feedstocks (Dollars per Barrel)



Technicians set up equipment near the Sweeny refinery's new HF alkylation unit, which went into service during the year. The unit enhances Phillips' ability to produce high-octane gasolines. Also, Sweeny produced its last barrel of leaded gasoline in 1989.

Chemicals

Chemicals' earnings fell as volumes and margins softened from their historic highs of 1988. An explosion and fire at the Houston Chemical Complex in October halted domestic polyethylene production. Various expansions for other chemicals went onstream or were in progress during the year.

Profit Falls on Lower Margins/Volumes

Chemicals had net income of \$439 million, compared with \$595 million in 1988. The decline came mainly as a result of lower plastics margins, lower olefins sales volumes and a loss of sales associated with the Houston accident.

Phillips plans to direct 18 percent of its 1990 capital expenditure and investment budget, or \$213 million, to chemicals operations. Major expenditures will go to increase ethylene capacity and to expand output of K-Resin copolymer. Another large project will be continued restoration of polyethylene capacity destroyed by the Houston accident. Its replacement costs are not included in the capital budget, as they are expected to be substantially covered by insurance. Largest capital projects in 1989 were capacity expansions in ethylene, polyethylene and K-Resin.

Strengths: Solid Feedstock Position, Internal Markets

Thanks to Phillips' position as the nation's largest producer of gas liquids, the company is able to upgrade low-cost feedstocks into products of greater value. Aside from a secure source of feedstock, this also helps ensure markets for certain products. For instance, a substantial percentage of Phillips' olefins is used in polyolefins manufactured by the company.

In addition, Chemicals is backed by a strong research and development team that continues to develop new products. Recent efforts have led to new films for grocery sacks and stretch wrap, as well as to a new pilot plant for sulfur chemicals.

Polyethylene Recovery Program Well Under Way

At year-end, Phillips was well along in a plan to restore its U.S. polyethylene facilities, destroyed by an explosion and fire at the Houston Chemical Complex (HCC) in October. The accident, which killed 23 people, decimated a 20-acre section of the plant and brought the company's domestic polyethylene production to a virtual standstill. Other production facilities at the Houston site—for K-Resin and polypropylene—suffered minor damage and returned to operation before year-end.

After the accident, Phillips announced plans to restore polyethylene capacity to 1.8 billion pounds a year, the level that existed or was under construction at the time of the explosion. Some 300 million pounds of capacity is expected to be onstream by summer 1990, with a total of about 600 million pounds available by fall. An additional 600 million pounds is planned for mid-year 1991.

Capacity restoration is expected to be substantially funded by property-loss insurance coverage, while business interruption insurance is expected to provide protection for earnings losses arising from the accident.

Ethylene Plant Construction Begins

Construction of a new 1.5-billion-pound-a-year ethylene plant near the company's Sweeny complex got under way in the spring. The plant will be owned by a partnership in which Phillips has a 50 percent interest and is the company's largest downstream venture in recent years. About 80 percent of the plant's production is committed under long-term contracts.

Aromatics, Specialties at Record Level

Olefins. Ethylene sales volumes for the year were down, mainly because of lower demand and cutbacks after the HCC accident. Phillips is one of the industry's larger producers of olefins such as ethylene, a major ingredient in many plastics. Volumes for propylene, the precursor of polypropylene plastics, were also lower.

Earnings
(Millions of Dollars)



Capital Expenditures
(Millions of Dollars)



Ethylene and Propylene Outside Sales
(Millions of Pounds)





Construction was about 15 percent complete at year-end on a new ethylene plant, going up next to Phillips' refinery and petrochemical complex in Sweeny, Texas. The facility is expected to be completed in early 1991.



A 55-pound bag of Marlex polyethylene, left, awaits shipment from the company's plant in Singapore. Some volumes were diverted to the U.S. after the MCC accident in October, making the Asian facility Phillips' sole polyethylene manufacturing site. New capacity at Houston is expected by mid-year.

Aromatics. Sales volumes rose to record levels for cyclohexane and paraxylene, feedstocks for nylon and polyester. Phillips has aromatics production facilities in Borger, Sweeny and Puerto Rico, and is the nation's leading supplier of cyclohexane.

Specialties. Profits and sales volumes were generally higher for this area, which encompasses mining and oilfield chemicals, catalysts and specialty chemicals. Specialty chemicals, including sulfur chemicals and solvents, had record profit for the second year in a row.

Worldwide Plastics Results Lower

Polyethylene/Polypropylene. Sales volumes of high-density polyethylene declined slightly in the wake of the HCC explosion. Polypropylene sales volumes were also down to a small extent. Margins contracted sharply during the year for almost all polyolefins, as product prices fell to a greater extent than feedstock costs.

K-Resin/Ryton. Sales of K-Resin copolymer were virtually the same in 1989 because of production constraints. A 50 percent capacity expansion at Houston is scheduled to go into operation in spring 1990. Worldwide sales volumes of Ryton engineering plastics declined.

Driscopipe. Sales volumes for Phillips Driscopipe, Inc. were about the same as the previous year. The subsidiary manufactures polyethylene pipe mainly for utility and industrial uses. Driscopipe in 1990 plans to introduce a new product for the large-diameter pipe market now dominated by concrete.

Fibers. Sales volumes were up for Phillips Fibers Corporation, a manufacturer of polypropylene fibers for use in carpets and home furnishings.

Strategies: Adding Capacity, Products and Markets

Building New Capacity. The company is well along in its efforts to add new capacity, especially in the areas of olefins and plastics. In 1989, construction started on a new ethylene plant, work on restoration of U.S. polyethylene capacity was accelerated and a K-Resin expansion neared completion. Additionally, an ethylene efficiency improvement project came onstream, boosting capacity about 4 percent. Expansions also were completed or taking place at year-end in specialty chemicals, fibers and catalysts.

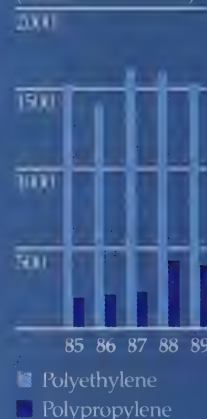
Developing New Products. Strides were made during the year to commercialize new products developed earlier by Phillips researchers.

Based on market development work done in 1989, good prospects were identified for Crystalor polymethylpentene, a premium thermoplastic, in conjunction with microwave cookware and plastic bottles. Alpha polyolefin fiber is expected to make its commercial debut in floor mats of 1991 automotive products. And early market development indicated that Aspect polyester compounds appear well-suited for automotive uses such as throttle sensors and for electrical and electronic applications.

Reaching Out for New Markets. In response to growing overseas demand for plastics and petrochemicals, the company continued to study locating new plants outside the United States. In 1989, Phillips dedicated a new polyethylene-pipe resin compounding facility in Singapore and moved ahead with a Ryton compounding unit there.

	Millions of Dollars				
Operating Revenues	1989	1988	1987	1986	1985
Petrochemicals	\$1,107	1,034	836	748	1,097
Plastic resins	1,004	1,155	783	622	625
Synthetic fibers	171	163	158	146	139
Plastic pipe	128	130	101	87	91
Other sales and services	39	36	50	28	47
Sold operations	—	—	—	67	267
	\$2,449	2,518	1,928	1,698	2,266

Polyethylene and Polypropylene Outside Sales (Millions of Pounds)



Ethylene Capacity Utilization Rate (Percent of Rated Capacity)



Polyethylene Capacity Utilization Rate (Percent of Rated Capacity)



*U.S. polyethylene production capacity destroyed by explosion and fire (After 1989)



Cups and food trays on most U.S. airlines are made using Phillips' K-Resin copolymer. Blended with polystyrene, the product yields a plastic of good clarity and flexibility. A major K-Resin capacity expansion is expected to go into operation in 1990.

Technology

Phillips' research and development organization in 1989 started up new pilot plants, made further advances in polymers and participated in an industry effort to devise cleaner-burning transportation fuels.

Environmental, Polymer Developments Highlight Year

Environment. In light of increasingly stringent emissions standards, successful hydro-treatment experiments were conducted during the year that achieved up to a 75 percent reduction in the sulfur level of distillates. Based partly on these studies, company refineries are expected to make the investments needed to realize such sulfur reductions in diesel fuel.

Further, Phillips was selected as the exclusive producer of reference fuels for a joint auto- and oil-industry venture aimed at developing cleaner-burning, reformulated gasolines. The company also is carrying out independent studies regarding the emissions of its own fuels.

New Pilot Plant Facilities. Construction of three new pilot plant facilities was completed during the year. The plants will be used to develop and test enhanced versions of K-Resin and polyethylene and will allow production of custom resins for packaging uses. In addition, a pilot plant to support Phillips' specialty chemicals business was expanded.

At year-end, 58 pilot plants were in operation at the Bartlesville Research Center. Such pilot facilities typically allow the company to test new processes and test-market new products before undertaking full-scale commercialization and production.

Plastics Developments. A new engineering polymer—polyphenylene sulfide sulfone—was introduced in 1989. Compared with more conventional engineering materials, the resin is able to maintain its load-bearing strength at much higher temperatures. It is expected to find wide use in automotive parts such as fuel pumps and distributors as well as aerospace components. Sizable quantities were produced during the year in a Bartlesville pilot plant to support market development.

Also, manufacturing and compounding improvements led to the production of new compounds of Ryton polyphenylene sulfide engineering plastics. These new materials, with superior strength and impact resistance, had their commercial debut in 1989 and are in production at the company's Ryton plant in Borger, Texas.

Materials Analysis. The company continued to expand the use of robots to conduct laboratory operations at the Bartlesville Research Center. One of these systems was placed in the quality control laboratory of Phillips' advanced composites facility during the year. By assuming potentially hazardous tasks once performed by personnel, the robot has enhanced safety while nearly doubling productivity for the tests it performs. At year-end, eight such robots were in use at the research center.

Patents. Phillips received 145 U.S. and 254 foreign patents in 1989. At the end of the year, the company held 4,331 active U.S. patents, among the most of any oil company. At year-end, the company's patented products and processes were used in 39 countries.

Provesta Sales Up Threefold

Revenues for the company's Provesta Corporation tripled in 1989, compared with the previous year. Provesta produces flavor enhancers, food bars and animal feed, based on Phillips' technology. The subsidiary also markets biological pesticides through a joint-venture company, AgriSense.

During the year, a new Provesta yeast product was developed and test-marketed for the aquaculture industry. The product contains high levels of a natural, coral-colored pigment, which gives a more appetizing, natural cast to farm-raised fish. Development and market-testing will continue in 1990.

New technologies will play a crucial role as we tackle environmental issues such as waste minimization or cleaner-burning gasoline. These demands are sure to alter our industry, which in turn will present business opportunities for those companies that can best meet these needs. Given these circumstances, there couldn't be a better time to have the kind of strong research capability that Phillips is known for.

Dave Tippecanoe

Senior Vice
President,
Planning &
Technology



**Licensing
Revenues**
(Millions of Dollars)

75



**Research and
Development
Expenses**
(Millions of Dollars)

150



Laboratory technician Janice Spurgeon conducts tests on the company's new laser catalyst, which converts carbon monoxide to carbon dioxide. A leading research magazine in 1989 named the catalyst one of the nation's most promising new technical products.

Environment & Citizenship

Phillips works hard to be a good citizen, caring neighbor and sensitive employer. The company invests not only in new plants and equipment but also in a high quality of life. Responsible citizenship extends to safeguarding the environment and encouraging oil and gas exploration in stable parts of the world. During the year, Phillips formed a new organization dedicated to the environment, issued a corporate policy making environmental leadership a prime mission and continued to promote responsible energy and economic policies.

Environment to Headline Decade

Few concerns in the 1990s promise to affect Phillips as much as the increasing emphasis on environmental protection. Newly enacted and proposed regulations on emissions and products could lead to substantial new investments and different ways of operating. Environmentally related projects' share of company capital spending—about 10 percent in recent years—could well double in the future. In addition, Phillips is working to develop cleaner-burning, reformulated gasolines and is considering alternative transportation fuels such as propane and compressed natural gas.

In light of this increasing emphasis on the environment, Phillips in 1989 created a new organization, reporting directly to the president, charged with environmental oversight. The company also issued a new environmental policy that identifies environmental leadership as a major corporate objective.

Some examples of Phillips' commitment to a clean environment that took shape in 1989 or are planned for 1990:

■ A new specialty chemicals unit that went onstream at Borger was designed to be virtually emissions-free. The unit underscores the company's conviction that the best way to control emissions is not to release them into the environment.

■ Phillips' Waste Minimization Committee, formed during the year, proposed that certain materials be eliminated from Phillips' operations in cases when alternatives might pose less environmental risk. In 1990, the committee will establish specific waste minimization goals for company sites.

■ The Borger refinery devised a means of cleaning up nearby storage pits containing "pitch"—heavy residual crude once considered unprocessable—by recycling it back through the refinery. The process not only cleans up the land, it also results in the production of useful petroleum products and energy.

■ Phillips became an early advocate of "Responsible Care," a chemical industry initiative through which companies share ideas on environmental concerns, strive to improve performance and thus seek better relations with the public.

■ Phillips in 1990 is expected to begin marketing clean-burning propane as a motor fuel. Initial operations will take place in Denver but could well expand to other areas.

Meanwhile, capital expenditures of \$76 million were approved to protect and improve the environment in 1989, while another \$127 million was spent on existing environmental control systems. During the year, design and permitting continued on a hazardous waste incinerator at the Sweeny refinery and a unit to neutralize caustics was installed at the Borger refinery. Also, to help ensure compliance with environmental regulations, Phillips in 1989 conducted safety and environmental reviews at 41 locations.

HCC Accident Jars Safety Record

The company's safety record for 1989 was jarred by an explosion at the Houston Chemical Complex that claimed 23 lives. Overall, recordable injuries in 1989 increased about 40 percent, and lost-workday cases rose nearly fourfold. Outside of the HCC accident, the safety record was virtually the same as for the previous year.

Charitable Contributions
(Millions of Dollars)



Environmental Expenditures*
(Millions of Dollars)



*Capital and expense



Concern for the environment goes well beyond Phillips' policies and plants, extending even to its products. The company's polypropylene-based Supac geotextile — in use on the stretch of South Carolina beach above — is renowned for its erosion-fighting qualities.



Working in cooperation with state agencies in Oklahoma, Phillips makes thousands of these birdbox kits, left, available to public schools, as a means of inspiring environmental awareness in the state's youth.

During the year, Phillips' Spartanburg fibers plant set a new company safety record, reaching 9.7 million hours without a lost-time injury at year-end. The previous Phillips mark—also the U.S. refining industry record—was 9.1 million hours at the Borger refinery.

Work Force Edges Up

After several years of consolidation, Phillips' work force increased by about 800 employees during 1989, ending the year at 21,800. New college hires accounted for about 20 percent of the increase. Additions resulted primarily from expansion projects in downstream operations.

Charitable Donations Total \$6 Million

In 1989, Phillips contributed \$6 million to organizations involved in youth, civic, cultural, educational, health and welfare activities. Of this, approximately \$2.7 million went to education. Some 422 colleges and universities benefited from this support.

Amateur Swimmers, Divers Receive Company Support

Phillips continued in 1989 as national sponsor of United States Swimming and United States Diving. The organizations sponsor swimming and diving clinics and competitions for youngsters, and they help prepare U.S. athletes for the Olympics. The company has been national sponsor of U.S. Swimming since 1973 and U.S. Diving since 1979.

Initial ESOP Distributions Made

Some 1.4 million shares of Phillips stock were distributed to employee accounts during the year, marking the first allocations under the company's Long-Term Stock Savings Plan. Through the plan, adopted in 1988, employees will be allocated some 14.3 million shares over a 10-year period ending in 1998. At year-end, about 20 percent of Phillips stock was held in company benefit plans for employees.

Employee Programs Identify Savings

The company's suggestion plan showed somewhat less activity than the previous year. First-year tangible savings from employee suggestions were \$10.9 million, compared with \$13.1 million in 1988. Employees received a total of \$942,000 for their suggestions. One employee, Arlen Wiens of Bartlesville, received the maximum award of \$50,000, while two employees—Bill Brown and Randy Everett of Sweeny—shared the maximum amount. Their suggestions were expected to result in net first-year savings of \$1.8 million.

Savings achieved through the company's Participative Action Teams totaled \$15.5 million for the year. These teams, involving 1,650 employees, meet to solve work-related problems and encourage innovation.

Some 21,500 shares of common stock were distributed to 183 employees through the Employee Performance Program, designed to salute outstanding performance by employees.

Phillips Helps Shape Public Policy

Phillips continued and broadened its efforts to work with state, local, national and international governments in the development of public policies of interest to the company. Phillips supports free-market energy policies and has provided input to the U.S. government for development of national energy strategy. The company also has promoted sound environmental regulations, concentrating on issues such as reauthorization of the federal Clean Air Act. Phillips has advocated rational solid waste management practices, including recycling, and has encouraged debate on the global warming issue. The company plans to maintain a leadership position to help ensure the enactment of responsible legislation affecting energy, the environment and the economy.

Financial Review 1989

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Oil and Gas Operations

In accordance with Financial Accounting Standards Board (FASB) Statement No. 69, "Disclosures about Oil and Gas Producing Activities," and regulations of the Securities and Exchange Commission (SEC), the company is making certain disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that some of the data are necessarily imprecise and represent only approximate amounts because of the subjective judgments involved in developing such information. Accordingly, this information may not necessarily represent the present financial condition of the company or its expected future results.

MANAGEMENT'S DISCUSSION AND ANALYSIS

February 13, 1990

Management's Discussion and Analysis is the company's analysis of its financial performance and of significant trends which may impact future performance. It should be read in conjunction with the financial statements and notes, supplemental oil and gas disclosures, and five-year financial and operating reviews.

SIGNIFICANT EVENTS

- Consolidated net income for 1989 was \$219 million, compared with \$650 and \$35 million for 1988 and 1987, respectively. Total revenues for 1989 were \$12.5 billion, compared with \$11.5 billion for 1988 and \$10.9 billion for 1987.
- In the fourth quarter, the company recorded a \$280 million after-tax writedown of its offshore California investments. Continued delays in receiving regulatory approval to begin production from the Point Arguello field prompted the writedown.
- Late in October, an explosion and fire at the Houston Chemical Complex (HCC) destroyed the company's U.S. polyethylene production facilities. At year-end, construction activities were under way, as the company initiated plans to restore its polyethylene business.
- In 1989, Phillips redeemed its remaining Floating Rate Senior Notes Due 1995 and 12% Notes Due September 1, 1992. Total debt declined \$869 million.
- During 1989, the company installed a concrete wave barrier around the oil storage and processing tank at the Greater Ekofisk Development in the Norwegian North Sea, completing the final phase of a four-year project to alleviate the effects of subsidence of the ocean floor.

Summary of Net Income

Years Ended December 31	Millions of Dollars		
	1989	1988	1987
Petroleum			
Exploration and Production			
United States	\$ (91)	45	(27)
Outside United States	193	190	117
	102	235	90
Gas and Gas Liquids	50*	9	22
Petroleum Products	176*	312	121
	328	556	233
Chemicals	439	595	303
Corporate and Other	(548)	(501)	(501)
Net Income	\$ 219	650	35

*Effective January 1, 1989, the method for calculating the transfer price for unfractionated natural gas liquids sold to Petroleum Products was revised. The revision increased Gas and Gas Liquids and decreased Petroleum Products net income an estimated \$32 million in 1989.

PHILLIPS PETROLEUM COMPANY

RESULTS OF OPERATIONS

Net income for 1989 was \$219 million, compared with \$650 million in 1988. The decrease was the result of the \$280 million after-tax writedown of offshore California investments and higher downstream feedstock and operating costs that could not be fully recovered by higher sales prices. Lower olefins sales volumes and the effect of the HCC explosion and fire also contributed to lower 1989 earnings. These factors were partially offset by higher worldwide crude oil sales prices.

The company wrote down its offshore California investments \$423 million (before-tax). The writedown was prompted by continued delays in receiving regulatory approval to begin oil and gas production. The writedown is reflected in the Consolidated Statement of Income as follows:

	Millions of Dollars
Equity in earnings of affiliated companies	\$ 39
Exploration expenses	130
Depreciation, depletion, amortization and retirements	254
	\$423

The after-tax effect of the writedown decreased earnings for U.S. Exploration and Production, Petroleum Products, and Corporate and Other \$220, \$13 and \$47 million, respectively.

The following table shows the change in 1989 average sales prices compared with 1988 prices.

	1989	1988	Change
Exploration and Production			
Crude Oil (per barrel)			
United States	\$16.60	13.41	24%
Outside United States	17.72	14.77	20
Worldwide	17.21	14.11	22
Natural Gas—Lease (per thousand cubic feet)			
United States	1.59	1.53	4
Outside United States	2.30	2.60	(12)
Worldwide	1.84	1.88	(2)
Gas and Gas Liquids			
U.S. Residue Gas (per thousand cubic feet)	1.71	1.63	5
U.S. Natural Gas Liquids (per barrel—unfractionated)	8.32*	6.96	20
Petroleum Products			
U.S. Natural Gas Liquids (per barrel—fractionated)	10.54	10.04	5
Automotive Gasoline (per gallon)	.63	.54	17
Distillates (per gallon)	.57	.48	19
Liquefied Petroleum Gas (per gallon)	.27	.26	4

*Transfer pricing revised effective January 1, 1989.

The company's 1989 worldwide crude oil production declined 2 percent due primarily to the natural decline in U.S. fields. Natural gas production increased 5 percent while production of natural gas liquids fell 12 percent. Natural gas production was up as a result of U.S. development projects and higher production from the United Kingdom. The decline in natural gas liquids production was due to low liquids prices for most of 1989.

Exploration and Production

Earnings for 1989 were \$102 million, compared with \$235 and \$90 million in 1988 and 1987, respectively.

Domestic operations showed a \$91 million loss in 1989, compared with income of \$45 million in 1988 and a loss of \$27 million in 1987. The writedown of offshore California investments in 1989 and lower crude oil production, partially offset by higher crude oil prices and higher natural gas prices and production, resulted in the \$136 million decrease from 1988.

Outside the United States, earnings were \$193 million in 1989, compared with \$190 and \$117 million in 1988 and 1987, respectively. The improvement in 1989 was primarily due to higher crude oil prices and natural gas production. These factors were partly offset by lower crude oil production, lower natural gas prices and higher lifting costs, mainly associated with the installation of a concrete wave barrier at the Ekofisk field in the summer of 1989.

Gas and Gas Liquids

In 1989, earnings were \$50 million, compared with \$9 million in 1988 and \$22 million in 1987. The improvement from 1988 was due to higher residue gas and natural gas liquids sales prices, slightly higher residue gas volumes and lower costs. These favorable factors were partially offset by lower natural gas liquids and methanol sales volumes.

Petroleum Products

Petroleum Products reported earnings of \$176 million in 1989, compared with \$312 and \$121 million in 1988 and 1987, respectively. Shrinking margins and lower U.S. sales volumes were primarily responsible for the decrease in 1989 as higher costs could not be fully recovered by higher sales prices.

Chemicals

Earnings were \$439 million in 1989 versus \$595 million in 1988 and \$303 million in 1987. Lower earnings in 1989 were primarily due to lower margins for plastics, lower olefins sales volumes and a loss of sales due to the explosion and fire at HCC. During the fourth quarter, the company met the \$50 million deductible under its business interruption insurance.

Corporate and Other

Corporate and Other reported a loss of \$548 million in 1989, compared with a loss of \$501 million in both 1988 and 1987, respectively. The increase in the loss for 1989 was primarily due to the writedown of capitalized interest associated with the offshore California investments mitigated by lower interest expense. In addition, 1988 benefited from gains from asset sales.

Provision for Income Taxes

The provision for income taxes was \$317 million, compared with \$465 and \$231 million in 1988 and 1987, respectively. The decrease in 1989 was due primarily to lower pretax earnings. The effective income tax rate was 59 percent in 1989, compared with 42 percent in 1988 and 87 percent in 1987. The predominance of highly taxed foreign income, coupled with domestic losses which are benefited at lower tax rates, was the primary reason for the higher effective tax rate in 1989.

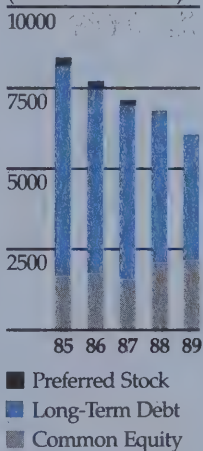
The company is not required to adopt FASB Statement No. 96, "Accounting for Income Taxes," until 1992. Should the company elect to adopt Statement No. 96 effective January 1, 1990, the one-time benefit to net income resulting from the cumulative effect of the change in accounting principle would be approximately \$130 million.

CAPITAL RESOURCES AND LIQUIDITY

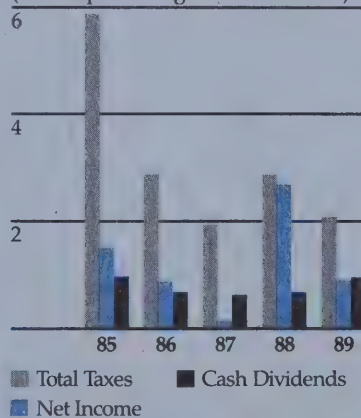
In 1989, cash and cash equivalent balances were allowed to decline by \$371 million as the company gained greater financial flexibility through its reduction of debt. Over the past three years, the company had maintained cash and cash equivalent balances in excess of its daily operating needs.

The company's current ratio, the ratio of current assets to current liabilities, was 1.1 at year-end 1989, compared with 1.2 in 1988. The company's short-term liquidity position at December 31, 1989, was approximately \$426 million stronger than indicated

Capitalization
(Millions of Dollars)



Total Taxes, Net Income And Cash Dividends
(Dollars per Average Common Share)



because 88 percent of product inventories are valued using the last-in, first-out (LIFO) method. The LIFO method values inventories at historical costs which are lower than current prices.

In 1989, total debt declined \$869 million as the company reached its goal of reducing total debt to approximately \$4 billion. The decrease primarily resulted from the redemption of the remaining Floating Rate Senior Notes Due 1995, the redemption of the 12 $\frac{7}{8}$ % Notes Due September 1, 1992, and the retirement of the remaining obligation under the Production Payment. The company has \$802 million available through various revolving bank lines of credit. Of this, \$630 million had been drawn down at December 31, 1989. In addition, the company had issued \$115 million under its \$250 million commercial paper program.

In order to reduce interest expense, the company is reviewing refinancing alternatives for its high-coupon, fixed-rate debt, callable in 1992. The refinancing efforts will be enhanced by the company's investment-grade debt ratings, achieved during 1989 and 1988.

The operations of an integrated petroleum company such as Phillips are capital intensive, requiring significant capital investments over long periods. Capital expenditures for properties, plants and equipment were \$872 million in 1989, compared with \$797 and \$737 million in 1988 and 1987, respectively. During this three-year period, significant expenditures have been directed toward domestic development projects offshore California and in the Gulf of Mexico; expanding the waterflood project in the Norwegian North Sea; connecting new gas supplies to existing facilities; constructing a new alkylation unit at the Sweeny, Texas, refinery; modernizing Phillips retail marketing outlets and increasing chemical production capacities. Over the three-year period ending December 31, 1989, capital expenditures directed toward Exploration and Production projects accounted for 51 percent of the total; Gas and Gas Liquids—5 percent; Petroleum Products—19 percent; Chemicals—15 percent; and Corporate and Other—10 percent.

In addition to capital expenditures, the company has charged against income a total of \$1.1 billion relating principally to its worldwide exploration program over the last three years. A comparison of the components of exploration expense is shown below.

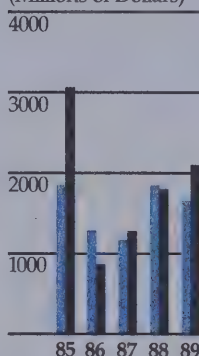
	Millions of Dollars		
	1989	1988	1987
Geological and geophysical	\$147	105	130
Leasehold impairment	179	161	196
Dry holes	80	41	31
Lease rentals	7	9	9
	\$413*	316	366

*Includes \$130 million applicable to the writedown of offshore California investments, of which \$93 and \$37 million are included in leasehold impairment and dry holes, respectively.

On October 23, 1989, an explosion and fire occurred at the Houston Chemical Complex owned by the company's wholly owned subsidiary, Phillips 66 Company, which resulted in 23 fatalities. The company's U.S. polyethylene manufacturing facilities were destroyed in the accident. The facilities were covered by property insurance for the actual replacement cost of the damaged facilities. In addition, business interruption insurance is expected to provide protection for earnings losses for both the damaged facilities, as well as other company operations dependent on the plant. The company has combined coverage for property and business interruption insurance of about \$1.3 billion. The company's operations are also covered by casualty insurance. By year-end, the company had met the deductibles associated with its insurance coverage. The company expects to realize a financial gain from its replacement cost property insurance.

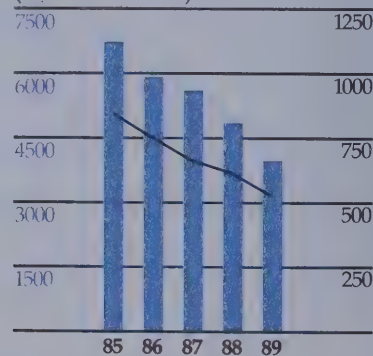
At the time of the accident, an expansion unit, in the form of a new plant with a rated capacity of 300 million pounds of polyethylene per year, was under construction. This site and the related equipment were not damaged. Completion is being expedited, and it is anticipated to come onstream in June 1990. An expansion at the new plant of an additional 300 million pounds has been authorized and is expected to begin operation in late 1990. A second plant, currently in the design phase, will bring total capacity up to 1.2 billion pounds by mid-1991. The company is exploring ways to restore polyethylene capacity to 1.8 billion pounds a year, the level that existed or was under construction at the time of the accident.

Analysis of Cash Flows*
(Millions of Dollars)



■ Cash Flow From Operating Activities
■ Investing and Financing Activities

Debt and Interest
(Millions of Dollars)



■ Total Debt Balances at Year-End
■ Interest Expense on Debt

*The difference between cash flow from operating activities and investing and financing activities equals the change in cash.

Construction has begun on a 1.5-billion-pound-per-year ethylene plant which is expected to be completed in 1991. The plant is owned by a partnership in which the company holds a 50 percent interest. Construction of the plant and working capital requirements are being funded by financing arranged by the partnership, as well as by the partners' equity contributions. The financing is secured by the project's assets and long-term sales agreements for the ethylene to be produced from the new facility and is nonrecourse to the investors in the partnership. The company has certain commitments to the partnership which include funding the cost of the project above a specified level through the use of loans, constructing common facilities and agreeing to purchase the unsold production from the facility up to a specified maximum quantity.

Early in 1990, the company received net proceeds of \$91 million in a settlement from the Government of Iran and the National Iranian Oil Company. The settlement is the result of favorable arbitration by the Iran-United States Claims Tribunal in The Hague, Netherlands over the 1979 expropriation of Phillips' interest in two producing offshore Iranian oil fields and concludes all claims and counterclaims.

The company's major net income exposures to foreign currency movements are due to its foreign deferred tax liabilities. Changes in the value of the dollar against certain foreign currencies can result in sizable fluctuations in net income because FASB Statement No. 52, "Foreign Currency Translation," requires foreign deferred taxes to be valued at current exchange rates. The company does not hedge these exposures because gains and losses on foreign deferred taxes do not impact cash flow. The company hedges, where feasible and appropriate, foreign exchange exposures which impact cash flow.

OUTLOOK

- The company has budgeted approximately \$1.2 billion for capital projects in 1990. Major capital expenditures for upstream projects will include expansion of the Ekofisk field waterflood project; increased foreign exploration projects; development projects both domestically in the Gulf of Mexico and the San Juan Basin of New Mexico, and overseas in Nigeria, Indonesia and the U.K. sector of the North Sea; and connecting new gas supplies to existing facilities.

Downstream capital expenditures will be directed toward building new company-owned retail marketing outlets and a waste incinerator at the Sweeny, Texas, refinery, and expanding ethylene and

K-Resin manufacturing capacities. Restoration of the polyethylene capacity destroyed by the explosion and fire in October is not included in the company's capital budget since proceeds from the company's replacement cost property insurance are expected to fund a substantial portion of the restoration.

- Construction is being expedited to quickly restore polyethylene production at HCC. One unit is under construction and a second has been approved. Together, these units will restore 1.2 billion pounds of production capacity a year by mid-1991. The company is exploring ways to restore polyethylene capacity to 1.8 billion pounds a year, the level that existed or was under construction at the time of the accident.
- About 60 percent of the ethylene production from the company's Sweeny refinery served as the principal raw material for the polyethylene operations at HCC. While domestic polyethylene capacity is being restored, some ethylene ordinarily directed to HCC is being sold to other companies or processed to Phillips' specifications by other companies under tolling arrangements. A combination of steps are being taken to handle ethylene production not utilized in these processing agreements, including reducing such production.
- The company and its co-venturers have been denied a permit to transport oil and gas production from the Point Arguello field offshore California. The company and its co-venturers have begun litigation seeking to overturn the ruling denying the permit. It is not known when oil and gas production will be allowed to commence.
- Over the last few years, the company has taken aggressive steps to reduce its debt to the \$4 billion level at year-end 1989. At this time, the company considers \$4 - \$4.5 billion of debt to be a reasonable level. Further reductions in debt to the extent of prior years' are not anticipated. As a result, the company anticipates directing most of its cash flow to increase capital spending and to enhance shareholder return.
- Late in 1989, the Board of Directors authorized the purchase of up to \$250 million of the company's common stock by year-end 1990. Stock purchased under the program will be held as treasury shares and may be used for general corporate purposes including employee incentive and savings programs.

QUARTERLY COMMON STOCK PRICES AND CASH DIVIDENDS PER SHARE

	Stock Price		Dividends
	High	Low	
1989			
First	\$23 $\frac{3}{4}$	19 $\frac{1}{8}$	.22
Second	24 $\frac{3}{4}$	21 $\frac{1}{8}$	.22
Third	30 $\frac{3}{4}$	21 $\frac{1}{8}$	.25
Fourth	27 $\frac{3}{4}$	21 $\frac{1}{8}$	.25
1988			
First	18 $\frac{1}{4}$	12 $\frac{1}{2}$	.15
Second	18 $\frac{3}{4}$	15 $\frac{3}{8}$	.15
Third	19 $\frac{3}{4}$	15 $\frac{3}{8}$	.18
Fourth	22 $\frac{3}{4}$	18	.18
Closing Stock Price at December 31, 1989			\$25.25
Number of Stockholders of Record at January 31, 1990			93,983

Phillips common stock is traded on the New York, Pacific and Toronto stock exchanges.

SELECTED FINANCIAL DATA

	Millions of Dollars Except Per Share Amounts				
	1989	1988	1987	1986	1985
Sales and other operating revenues	\$12,384	11,304	10,721	9,788	15,676
Net income	219	650	35	228	418
Net income per common share	.90	2.72	.06	.89	1.44
Total assets	11,256	11,968	12,111	12,403	14,052
Long-term debt	3,939	4,761	5,419	5,758	6,548
Redeemable preferred stock	—	—	205	270	281
Cash dividends declared per share					
Common	.94	.66	.60	.70	.95
Preferred	—	1.34	1.73	2.02	1.04

See Management's Discussion and Analysis for discussion of factors that would enhance an understanding of these financial data.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Phillips Petroleum Company

We have audited the accompanying consolidated balance sheets of Phillips Petroleum Company as of December 31, 1989 and 1988, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 1989. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Phillips Petroleum Company at December 31, 1989 and 1988, and the consolidated results of operations and cash flows for each of the three years in the period ended December 31, 1989 in conformity with generally accepted accounting principles.

Ernst + Young

Tulsa, Oklahoma
February 13, 1990

CONSOLIDATED STATEMENT OF INCOME

PHILLIPS PETROLEUM COMPANY

Years Ended December 31

Millions of Dollars

	1989	1988	1987
Revenues			
Sales and other operating revenues	\$12,384	11,304	10,721
Equity in earnings of affiliated companies	(7)	32	86
Other revenues	115	154	110
Total Revenues	12,492	11,490	10,917

Costs and Expenses

Purchased crude oil and products	7,185	6,176	6,221
Production and operating expenses	1,899	1,678	1,806
Exploration expenses	413	316	366
Selling, general and administrative expenses	517	439	420
Depreciation, depletion, amortization and retirements	1,106	868	892
Taxes other than income taxes	191	210	217
Interest and expense on indebtedness	645	688	729
Total Costs and Expenses	11,956	10,375	10,651
Income before income taxes	536	1,115	266
Provision for income taxes	317	465	231
Net Income	\$ 219	650	35

Net Income Applicable to Common Stock	\$ 219	639	13
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Net Income Per Share of Common Stock	\$.90	2.72	.06
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Average Common Shares Outstanding (in thousands)	243,738	234,984	228,326
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See Accounting Policies and Notes to Financial Statements.

CONSOLIDATED BALANCE SHEET

PHILLIPS PETROLEUM COMPANY

At December 31

Millions of Dollars

	1989	1988
Assets		
Cash and cash equivalents	\$ 708	1,079
Accounts and notes receivable (less allowances: 1989—\$18; 1988—\$17)	1,351	1,261
Inventories	584	562
Prepaid expenses and other current assets	233	160
Total Current Assets	2,876	3,062
Investments and long-term receivables	489	429
Properties, plants and equipment (net)	7,832	8,417
Deferred charges	59	60
Total Assets	\$11,256	11,968

Liabilities

Accounts payable	\$ 1,230	1,006
Notes payable	30	—
Long-term debt due within one year	56	133
Accrued income and other taxes	1,165	1,108
Other accruals	225	221
Total Current Liabilities	2,706	2,468
Long-term debt	3,939	4,761
Accrued dismantlement, removal and restoration costs	346	323
Deferred income taxes	1,721	1,874
Other liabilities and deferred credits	412	429
Total Liabilities	9,124	9,855

Stockholders' Equity

Common stock—500,000,000 shares authorized at \$1.25 par value

Issued (263,021,219 shares)		
Par value	329	329
Capital in excess of par	485	470
Treasury stock (at cost: 1989—19,125,846 shares; 1988—19,768,208 shares)	(1,155)	(1,198)
Foreign currency translation adjustments	(21)	(24)
Guarantees for Long-Term Stock Savings Plan (LTSSP)	(225)	(250)
Earnings employed in the business	2,719	2,786
Total Stockholders' Equity	2,132	2,113
Total Liabilities and Stockholders' Equity	\$11,256	11,968

See Accounting Policies and Notes to Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

PHILLIPS PETROLEUM COMPANY

Years Ended December 31

Millions of Dollars

	1989	1988	1987
Cash Flows from Operating Activities			
Net income	\$ 219	650	35
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, depletion, amortization and retirements	1,106	868	892
Dry hole costs and leasehold impairment	259	202	227
Deferred taxes	(153)	170	18
Decrease (increase) in accounts and notes receivable	(90)	8	(222)
Increase in inventories	(22)	(19)	(36)
Decrease (increase) in prepaid expenses and other current assets	8	(93)	40
Increase (decrease) in accounts payable	224	(10)	92
Increase in taxes and other accruals	61	121	80
Other	42	(32)	36
Net Cash Provided by Operating Activities	1,654	1,865	1,162
Cash Flows from Investing Activities			
Capital expenditures, including dry hole costs	(872)	(797)	(737)
Property dispositions	37	127	30
Investment purchases	(122)	(59)	(35)
Investment sales	19	19	1
Net Cash Used for Investing Activities	(938)	(710)	(741)
Cash Flows from Financing Activities			
Issuance of debt	825	687	—
Repayment of debt	(1,668)	(1,638)	(331)
Issuance of company stock	5	252	—
Purchase of company stock	—	(215)	(69)
Dividends paid	(229)	(168)	(156)
Redemption of Preferred Share Purchase Rights	(20)	—	—
Net Cash Used for Financing Activities	(1,087)	(1,082)	(556)
Increase (Decrease) in Cash and Cash Equivalents	(371)	73	(135)
Cash and cash equivalents at beginning of year	1,079	1,006	1,141
Cash and Cash Equivalents at End of Year	\$ 708	1,079	1,006

See Accounting Policies and Notes to Financial Statements.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

PHILLIPS PETROLEUM COMPANY

	Millions of Dollars							
	Shares of Common Stock		Common Stock			Foreign Currency Translation Adjustments	Guarantees for LTSSP	Earnings Employed in the Business
	Issued	Held in Treasury	Par Value	Capital in Excess of Par	Treasury Stock			
December 31, 1986	248,684,301	20,351,602	\$311	224	(1,241)	(49)	—	2,479
Net income								35
Cash dividends declared and paid								
Common								(137)
Preferred								(19)
Distributed under incentive compensation plans		(17,750)			3			(4)
Current period translation adjustment						18		
Accretion of discount on preferred stock								(3)
December 31, 1987	248,684,301	20,333,852	311	224	(1,238)	(31)	—	2,351
Net income								650
Cash dividends declared and paid								
Common								(157)
Preferred								(11)
Distributed under incentive compensation plans		(566,094)		12	40			(42)
Sold to LTSSP	14,336,918		18	232			(250)	
Current period translation adjustment						(2)		
Translation adjustment recognized upon disposal of foreign investments						9		
Accretion of discount on preferred stock and other		450		2				(5)
December 31, 1988	263,021,219	19,768,208	329	470	(1,198)	(24)	(250)	2,786
Net income								219
Cash dividends declared and paid on common stock								(229)
Redemption of Preferred Share Purchase Rights								(20)
Distributed under incentive compensation plans		(707,362)		14	44			(42)
Reduction of guarantees of LTSSP borrowings							25	
Current period translation adjustment						3		
Stock purchases		65,000			(1)			
Other				1				5
December 31, 1989	263,021,219	19,125,846	\$329	485	(1,155)	(21)	(225)	2,719

See Accounting Policies and Notes to Financial Statements.

■ Consolidation Principles and Investments—

All significant, majority-owned subsidiaries are consolidated. Investments in companies owned 20 to 50 percent and corporate joint ventures (affiliates) and other companies are accounted for using the equity method or cost, as appropriate.

■ Cash Equivalents—Cash equivalents are highly liquid short-term investments that are readily convertible to known amounts of cash and generally have original maturities within three months from their date of purchase.

■ Inventories—Crude oil and petroleum and chemical products are valued at cost, which is lower than market in the aggregate, mainly on the last-in, first-out (LIFO) basis. Materials and supplies are valued at or below average cost.

■ Oil and Gas Exploration and Development—Oil and gas exploration and development costs are accounted for using the successful efforts method of accounting.

Property Acquisition Costs—Oil and gas leasehold acquisition costs are capitalized. Leasehold impairment is recognized based on exploratory experience. Upon discovery of commercial reserves, leasehold costs are transferred to producing properties.

Exploratory Costs—Geological and geophysical expenses and the costs of carrying and retaining undeveloped properties are charged against income as incurred. Exploratory drilling costs are capitalized when incurred. If exploratory wells are determined to be commercially unsuccessful or dry holes, applicable costs are expensed.

Development Costs—Costs incurred to drill and equip development wells, including unsuccessful development wells, are capitalized.

Impairment of Proved Properties—For "ceiling test" calculations, all proved properties are evaluated in the aggregate using one worldwide cost center. Additionally, high-cost proved properties are evaluated prior to start-up of production and any significant impairment is recognized currently.

Depletion and Amortization—Leasehold costs of producing properties are depleted using the unit-of-production method based on estimated proved oil and gas reserves. Amortization of intangible development costs is based on the unit-of-production method using the estimated proved developed oil and gas reserves.

■ Depreciation and Amortization—Depreciation and amortization of properties, plants and equipment, including assets under capital leases, are determined by the group straight-line method, the individual unit straight-line method or the unit-of-production method, applying the method considered most appropriate for each type of property.

■ Property Dispositions—When complete units of depreciable property are retired or sold, the asset cost and related accumulated depreciation are eliminated with any gain or loss reflected in income. When less than complete units of depreciable property are disposed of or retired, the difference between asset cost and salvage value is charged or credited to accumulated depreciation.

■ Maintenance and Repairs—Maintenance and repair costs are expensed as incurred. Significant improvements are capitalized.

■ Dismantlement, Removal and Restoration Costs—The estimated costs, net of salvage values, of dismantling and removing major facilities, including necessary site restoration, are accrued using either the unit-of-production or the straight-line method.

■ Foreign Currency Translation—The U.S. dollar is the functional currency for most of the company's operations. Adjustments resulting from the process of translating foreign functional currency financial statements into U.S. dollars are accumulated as a separate component of stockholders' equity. Foreign currency transaction gains and losses are included in current earnings.

■ Income Taxes—Deferred taxes are provided for all significant timing differences in the recognition of revenues and expenses for tax and financial purposes. Allowable tax credits are applied currently as reductions of the provision for income taxes. No provision for U.S. income taxes is made on undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds.

■ Income Per Share of Common Stock—Income per share of common stock is determined after deducting the dividend requirements of preferred stock and the accretion of the excess of redemption value of preferred stock over its carrying value. The calculation is based upon the daily weighted average number of common shares outstanding during the period.

NOTES TO FINANCIAL STATEMENTS

PHILLIPS PETROLEUM COMPANY

Note 1—Writedown of Offshore California Investments

In the fourth quarter of 1989, the company recorded a \$423 million before-tax charge for the writedown of its offshore California investments prompted by continuing delays in receiving the regulatory approvals necessary to begin crude oil and natural gas production. The writedown applies to the company's interest in the Point Arguello field and associated production, transportation and onshore processing facilities; suspended exploratory wells in the Rocky Point field; and other offshore California leases. On an after-tax basis, the writedown reduced 1989 net income \$280 million (\$1.15 per share).

Note 2—Inventories

Inventories at December 31 consisted of the following:

	Millions of Dollars	
	1989	1988
Crude oil and petroleum products	\$279	229
Chemical products	196	225
Materials, supplies and other	109	108
	\$584	562

Inventories valued on a LIFO basis totaled \$423 and \$396 million at December 31, 1989 and 1988, respectively, and would have been approximately \$426 and \$326 million higher, respectively, had they been valued using the first-in, first-out (FIFO) method.

Note 3—Investments and Long-Term Receivables

Components of investments and long-term receivables at December 31 were as follows:

	Millions of Dollars	
	1989	1988*
Investments in and advances to affiliated companies	\$448	367
Long-term receivables	31	52
Other investments	10	10
	\$489	429

*Reclassified to conform to current classification.

Earnings employed in the business at December 31, 1989, included \$108 million relating to undistributed earnings of affiliated companies. Distributions received from affiliated companies were \$56, \$41 and \$58 million in 1989, 1988 and 1987, respectively.

Note 4—Properties, Plants and Equipment

The company's investment in properties, plants and equipment (at cost) at December 31 is summarized as follows:

	Millions of Dollars	
	1989	1988
Exploration and Production	\$ 8,854	8,851
Gas and Gas Liquids	2,010	2,016
Petroleum Products	3,212	3,162
Chemicals	1,520	1,529
Corporate and Other	1,031	1,007
	16,627	16,565
Accumulated depreciation, depletion and amortization	8,795	8,148
	\$ 7,832	8,417

Note 5—Debt

Long-Term

Long-term debt due after one year at December 31 consisted of the following:

	Millions of Dollars	
	1989	1988
Floating Rate Senior Notes Due 1995	\$ —	440
14¾% Subordinated Debentures Due 2000	1,047	1,047
13¾% Senior Notes Due 1997	1,299	1,299
12⅞% Notes Due September 1, 1992	—	187
12¼% Debentures Due 2012	288	288
11¼% Debentures Due 2013	223	223
8⅞% Debentures Due 2000	103	103
7⅞% Debentures Due 2001	69	69
5½% Marine Terminal Revenue Bonds, Series 1977 Due 2007	20	20
Revolving debt due to banks and others through 1997 at 8½%-9⅞%	684	750
Production payment	—	103
Guarantees of LTSSP notes payable	200	225
Other obligations	6	7
	\$3,939	4,761

Interest rates on variable rate debt at December 31 were as follows:

	1989	1988
LTSSP notes payable	7.37%	7.95
Floating Rate Senior Notes Due 1995	—	10.94
Production payment	—	9.44

Maturities of long-term debt in 1990 through 1994 are: \$56 (included in current liabilities), \$87, \$110, \$387 and \$564 million, respectively.

The LTSSP notes payable are supported by irrevocable bank letters of credit with a scheduled expiration date of July 1994. (See Note 9 for additional

discussion of the LTSSP.) As part of its revolving debt, the company has a \$250 million commercial paper program also supported by a direct-pay irrevocable bank letter of credit with a scheduled expiration date of September 1994. Part of the LTSSP notes and commercial paper have been classified as noncurrent based on the company's ability and intent to refinance them on a long-term basis.

Each bank providing an irrevocable letter of credit for the LTSSP notes and the commercial paper program has the optional right, if the current directors or their approved successors cease to be a majority of the Board, and upon not less than 90 days' notice, to terminate its obligation under the agreements pertaining to the letters of credit.

Lines of Credit

The company has available \$802 million of bank lines of credit. At December 31, 1989, there was \$172 million remaining to be drawn down. Included in the agreements for \$500 million of these lines is a similar optional early termination right like that described in the preceding paragraph.

Compensating Balances

The company maintains compensating balances for banking services under various arrangements with several banks. The compensating balances are not legally restricted as to withdrawal and are continually reviewed and adjusted based on levels of services and activity. The total of all compensating balances is not material in relation to total liquid assets.

Note 6—Other Contingent Liabilities

The company has contingent liabilities resulting from throughput agreements with pipeline and processing companies in which it holds stock interests. Under these agreements, Phillips may be required to provide any such company with additional funds through advances against future charges for the shipping or processing of petroleum liquids, natural gas and refined products.

The company is a party to a number of legal proceedings pending in various courts or agencies in which it or a subsidiary appears as plaintiff or defendant for which no provision has been made.

While it is not possible at this time to establish the ultimate amount of liability with respect to contingent liabilities, including those related to legal proceedings, the company is of the opinion that the aggregate amount of any such liabilities for which provision has not been made will not have a material adverse effect on its financial position.

Note 7—Preferred Share Purchase Rights

On July 31, 1989, the company redeemed its outstanding Preferred Share Purchase Rights for 8½ cents per right and distributed to its shareholders one new Preferred Share Purchase Right (Right) for each outstanding share of the company's common stock. The newly issued Rights enable holders to either acquire additional shares of Phillips common stock or purchase the stock of the acquiring company at a discount, depending on specific circumstances. The Rights, which expire July 31, 1999, will be exercisable only if a person or group acquires 20 percent or more of the company's common stock or announces a tender offer which would result in ownership of 20 percent or more of the common stock. The Rights may be redeemed by the company in whole, but not in part, for one cent per Right. At December 31, 1989, there were 243,895,373 Rights outstanding.

Note 8—Non-Mineral Operating Leases

The company leases service stations, computers and other facilities and equipment. At December 31, 1989, future minimum payments due under noncancelable operating leases were as follows:

	Millions of Dollars
1990	\$ 34
1991	25
1992	14
1993	10
1994	10
Remaining years	59
	\$152

Operating lease rental expense for the years ended December 31 was as follows:

	Millions of Dollars		
	1989	1988	1987
Total rentals	\$81	83	84
Less sublease rentals	6	6	6
	\$75	77	78

Note 9—Employee Benefit Plans

Defined Benefit Plans

The company has defined benefit retirement plans covering substantially all employees. Plans are generally noncontributory with benefit formulas based on employee earnings and credited service. The company's funding policy for U.S. plans is to contribute the minimum required by the Employee Retirement Income Security Act of 1974. Contributions to foreign plans are dependent upon local laws and tax regulations. The company also sponsors nonqualified supplementary retirement plans for senior management and nonemployee directors.

Net pension cost was as follows:

	Millions of Dollars			
	U.S. Plans			Foreign Plans
	1989	1988	1987	1989
Service cost—benefits earned during the period	\$ 19	17	17	4
Interest cost on projected benefit obligation	23	19	16	6
Return on assets				
Actual	(57)	(35)	(10)	(11)
Deferred gains (losses)	34	16	(5)	3
Amortization of				
Net asset	(7)	(7)	(7)	—
Net gains	(1)	—	—	—
Net pension cost	\$ 11	10	11	2

In determining net pension cost, the company has elected to amortize net gains and losses on a straight-line basis over 10 years.

All of the company's funded plans have assets in excess of the accumulated benefit obligation. Assets include a participation right to an annuity contract, real estate, stocks, bonds and insurance contracts. A foreign plan also holds home mortgage loans. The following table presents the funded status of the plans and a reconciliation with accrued pension cost and deferred gain on reversion at December 31.

	Millions of Dollars		
	U.S. Plans		Foreign Plans
	1989	1988	1989
Plan assets at fair value	\$ 261	205	83
Actuarial present value of benefit obligations			
Vested benefits	79	42	33
Nonvested benefits	5	2	5
Accumulated benefit obligation	84	44	38
Effect of projected future salary increases	186	160	40
Projected benefit obligation	270	204	78
Excess assets (obligation)	(9)	1	5
Unrecognized prior service cost	8	—	—
Unrecognized net (gains) losses	(31)	(22)	2
Unrecognized net asset	(75)	(82)	(5)
(Accrued) prepaid pension cost and deferred gain on reversion	\$(107)	(103)	2

Assumptions—Weighted Average at December 31

Rate of increase in compensation levels	6.50%	6.50	7.55
Discount rate	9.50	9.75	9.90
Long-term rate of return on assets	11.75	11.25	11.35

Accrued pension cost and deferred gain on reversion is reflected in the Consolidated Balance Sheet as follows:

	Millions of Dollars	
	1989	1988
Prepaid expenses and other current assets	\$ 1	—
Deferred charges	5	5
Other accruals	(1)	(1)
Other liabilities and deferred credits	(110)	(107)
	\$(105)	(103)

Other Postretirement Plans

The company sponsors plans that provide certain health care and life insurance benefits for substantially all retired U.S. employees. Retirees essentially pay their own way and any liability that the company might have under the proposed FASB Statement, "Employers' Accounting for Postretirement Benefits Other Than Pensions," is not expected to be material. The majority of all foreign retirees are covered by government-sponsored programs.

Defined Contribution Plans

Most employees may elect to participate in the company-sponsored Thrift Plan by contributing a portion of their earnings to any of three different investment funds. A specified percentage of the employee contribution is matched by the company. Company contributions charged to expense were \$5, \$23 and \$25 million in 1989, 1988 and 1987, respectively.

In 1988, the company established the Long-Term Stock Savings Plan (LTSSP), an employee stock ownership plan. The LTSSP borrowed \$250 million to purchase 14,336,918 shares of authorized but previously unissued common stock from the company at \$17.4375 per share. Since the company has effectively guaranteed the LTSSP's borrowings, the unpaid balance is reported as a liability of the company and a corresponding amount, similar to unearned compensation, is shown as a reduction of stockholders' equity. Both the liability and the amount in stockholders' equity will be reduced in equal amounts as the LTSSP repays the borrowings. The LTSSP is repaying the loans over a 10-year period using company contributions and dividends received on the shares of common stock. Most employees may elect to participate in the LTSSP by contributing 1 percent of their earnings and receive an allocation of shares of common stock proportionate to their contribution.

Company contributions to the LTSSP in 1989 and 1988 were \$31 and \$2 million, respectively. Dividends used to service debt were \$12 and \$5 million in 1989 and 1988, respectively. Interest incurred on the LTSSP debt in 1989 and 1988 was \$18 and \$8 million, respectively.

Incentive Compensation Plans

At December 31, 1989, the company had three incentive compensation plans to provide awards to key employees—the Incentive Compensation Plan, and the 1986 and 1990 Stock Plans. In anticipation of awards that may become payable under the plans, provisions of \$31, \$25 and \$5 million have been charged against earnings in 1989, 1988 and 1987, respectively.

The 1986 and 1990 Stock Plans, each of which includes a Stock Option Plan and a Strategic Incentive Plan, are in effect for the five-year periods beginning January 1, 1986, through December 31, 1990, and January 1, 1990, through December 31, 1994, respectively. The maximum number of shares of the company's common stock that may be used to satisfy the plans' obligations, subject to stock splits, stock dividends and other similar actions, is approximately 16.5 million shares.

Stock options granted under provisions of the Stock Option Plans permit the purchase of shares of the company's common stock at exercise prices equivalent to the average market price of the stock on the date the options were granted. The options have a term of 10 years and normally become exercisable in increments up to 25 percent on each anniversary date following the date of grant. Stock Appreciation Rights (SARs) may from time to time be affixed to the options. Options exercised in the form of SARs permit the holder to receive stock, or a combination of cash and stock, equivalent to the excess of the average market price on the exercise date over the exercise price.

During 1989, the company granted options for 1,307,862 shares of stock; options for 14,039 shares were forfeited and options for 443,107 shares were exercised at prices ranging from \$12.63 to \$16.63 per share. At December 31, 1989, 4,545,634 shares were under option (including 1,066,234 with SARs) at exercise prices ranging from \$12.63 to \$27.50. Options for 975,046 shares were exercisable.

Note 10—Taxes

Taxes charged to income were as follows:

	Millions of Dollars		
	1989	1988	1987
Taxes Other Than Income Taxes			
Property	\$ 65	66	76
Production	67	61	65
Payroll	46	48	44
Environmental	18	19	17
Other	(5)	16	15
	191	210	217
Income Taxes			
Federal			
Current	59	77	23
Deferred	(111)	87	(142)
Foreign			
Current	374	314	181
Deferred	(19)	(36)	151
State and local (current)	14	23	18
	317	465	231
Total taxes charged to income	\$508	675	448

Deferred income taxes related to timing differences were:

	Millions of Dollars		
	1989	1988	1987
Depreciation	\$ (15)	2	138
Intangible drilling and certain other costs	21	(15)	(29)
Writedown of offshore California investments	(142)	—	—
Dismantlement provision	(9)	(9)	(16)
Leasehold impairment	(5)	58	(6)
Asset dispositions	7	(9)	3
Contingencies and accruals	7	17	(54)
Employee benefit plans	3	13	(18)
Interest rate swap agreements	3	3	(20)
Inventories	(6)	(1)	12
Other	6	(8)	(1)
	\$(130)	51	9

Deferred taxes have not been provided for the company's equity in undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds. At December 31, 1989, 1988 and 1987, the aggregate of these funds was \$231, \$267 and \$298 million, respectively, excluding amounts which, if remitted, would be expected to result in little or no tax because of available tax credits and deductions.

The amounts of U.S. and outside U.S. income before income taxes and a reconciliation of tax at the federal statutory rate with the provision for income taxes follow:

	Millions of Dollars			Percent of Pretax Income		
	1989	1988	1987	1989	1988	1987
Income (loss) before income taxes						
United States	\$(127)	518	(305)	(23.7)%	46.5	(114.7)
Outside United States	663	597	571	123.7	53.5	214.7
	\$ 536	1,115	266	100.0%	100.0	100.0
Federal statutory income tax	\$ 182	379	106	34.0%	34.0	40.0
Foreign taxes in excess of federal statutory rate	146	80	144	27.2	7.2	54.1
Possession tax credit	(28)	(19)	(19)	(5.2)	(1.7)	(7.1)
Acquisition adjustments	—	—	(16)	—	—	(6.0)
State income taxes—net of federal benefit	9	15	11	1.7	1.3	4.1
Amortization of excess cost	5	3	6	.9	.3	2.2
Other	3	7	(1)	.5	.6	(.4)
	\$ 317	465	231	59.1%	41.7	86.9

Excise taxes collected on the sale of petroleum products and paid to taxing agencies were \$449, \$499 and \$206 million for the years ended December 31, 1989, 1988 and 1987, respectively. These taxes are excluded from reported revenues.

All deficiencies related to the examination of the company's U.S. income tax returns by the Internal Revenue Service have been settled through 1974. The company is of the opinion that any unsettled deficiencies for subsequent years will not have a material effect on the financial position of the company.

The company is not required to adopt FASB Statement No. 96, "Accounting for Income Taxes," until 1992. Should the company elect to adopt Statement No. 96 effective January 1, 1990, the one-time benefit to net income resulting from the cumulative effect of the change in accounting principle would be approximately \$130 million.

Note 11—Cash Flow Information

	Millions of Dollars		
	1989	1988	1987
Noncash financing and investing activities			
Investment in joint ventures in exchange for noncash assets	\$ 24	43	—
Guarantees of LTSSP borrowings	—	250	—
Reduction of guarantees of LTSSP borrowings	25	—	—
Cash payments			
Interest	\$604	681	680
Income taxes	448	284	344

Note 12—Other Financial Information

	Millions of Dollars Except Per Share Amounts		
	1989	1988	1987
Interest Incurred			
Debt	\$543	637	666
Other	106	83	122
	649	720	788
Capitalized	(4)	(32)	(59)
Expensed	\$645	688	729
Maintenance and repairs—expensed*	\$568	435	499
Research and development expenditures—expensed	\$133	101	94
Foreign currency transaction gains (losses)—after-tax	\$ 12	29	(42)
Cash dividends declared and paid per share			
Common	\$.94	.66	.60
Preferred	—	1.34	1.73

*Includes expenses of \$150 million in 1987 to elevate six platforms offshore Norway and expenses of \$120 and \$41 million in 1989 and 1988, respectively, to construct a concrete wave barrier to protect a facility offshore Norway.

Note 13—Segment and Geographic Information

The company is involved primarily in Petroleum and Chemicals operations. Petroleum operations are fully integrated and involve the exploration, production, processing, transportation and refining of crude oil and natural gas, together with the subsequent transportation and marketing of products derived therefrom. This segment also provides feedstock for the production of petrochemicals. Chemicals operations involve the manufacture and marketing of a broad range of petroleum-based chemical products. Minerals and various other operations are included in Other.

Sales and other operating revenues to outside customers and sales within Phillips by business segment and by geographic area are at market value. Operating profit excludes general corporate revenue and expense, interest, minority interest and income taxes. The company's share of earnings of affiliated companies has been included with the segment and geographic area in which the affiliate operates. Income taxes are allocated based upon each segment's taxable income reduced by applicable tax credits. Corporate assets include cash and cash equivalents.

Analysis of Results by Business Segment

Millions of Dollars							
	Petroleum*						
	Exploration and Production	Gas and Gas Liquids	Petroleum Products	Total	Chemicals	Corporate and Other	Consolidated†
1989							
Sales and Other Operating Revenues							
Outside customers	\$1,284	789	7,855	9,928	2,449	7	12,384
Sales within Phillips	1,244	576	521	2,341‡	218	67	—
Segment sales	\$2,528	1,365	8,376	12,269	2,667	74	12,384
Operating Profit	\$ 395	82	260	737	652	2	1,391
Other revenues	—	—	—	—	—	2	2
Minority interest	—	(1)	—	(1)	(1)	1	(1)
Nonoperating items	—	—	—	—	—	(856)	(856)
Income taxes	(293)	(31)	(84)	(408)	(212)	303	(317)
Net income	\$ 102	50	176	328	439	(548)	219
Total Assets	\$4,236	1,016	2,965	8,217	1,377	1,662	11,256
Depreciation, Depletion and Amortization	\$ 699	121	111	931	60	115	1,106
Capital Expenditures	\$ 451	43	161	655	156	61	872
1988							
Sales and Other Operating Revenues							
Outside customers	\$1,224	785	6,763	8,772	2,518	14	11,304
Sales within Phillips	1,019	564	544	2,127‡	180	80	—
Segment sales	\$2,243	1,349	7,307	10,899	2,698	94	11,304
Operating Profit	\$ 526	15	471	1,012	911	46	1,969
Other revenues	—	—	—	—	—	55	55
Minority interest	—	(1)	—	(1)	(20)	1	(20)
Nonoperating items	—	—	—	—	—	(889)	(889)
Income taxes	(291)	(5)	(159)	(455)	(296)	286	(465)
Net income	\$ 235	9	312	556	595	(501)	650
Total Assets	\$4,729	1,144	2,707	8,580	1,349	2,039	11,968
Depreciation, Depletion and Amortization	\$ 552	110	102	764	57	47	868
Capital Expenditures	\$ 377	37	177	591	130	76	797
1987							
Sales and Other Operating Revenues							
Outside customers	\$1,187	767	6,809	8,763	1,928	30	10,721
Sales within Phillips	1,111	611	477	2,199‡	161	19	—
Segment sales	\$2,298	1,378	7,286	10,962	2,089	49	10,721
Operating Profit	\$ 381	39	201	621	482	(12)	1,091
Other revenues	—	—	—	—	—	139	139
Minority interest	—	—	—	—	(10)	2	(8)
Nonoperating items	—	—	—	—	—	(956)	(956)
Income taxes	(291)	(17)	(80)	(388)	(169)	326	(231)
Net income	\$ 90	22	121	233	303	(501)	35
Total Assets	\$5,192	1,236	2,643	9,071	1,165	1,875	12,111
Depreciation, Depletion and Amortization	\$ 600	113	113	826	63	3	892
Capital Expenditures	\$ 391	43	131	565	78	94	737

*Effective January 1, 1989, the method for calculating the transfer price for unfractionated natural gas liquids sold to Petroleum Products by Gas and Gas Liquids was revised. The revision increased Gas and Gas Liquids and decreased Petroleum Products net income an estimated \$32 million in 1989.

†After elimination of intersegment transactions.

‡Includes intra-Petroleum Operations sales of \$1,835, \$1,603 and \$1,743 million for 1989, 1988 and 1987, respectively.

Analysis of Results by Geographic Area

	Millions of Dollars						
	United States	Norway	United Kingdom	Africa	Other Areas	Corporate	Worldwide Consolidated*
1989							
Sales and Other Operating Revenues							
Outside customers	\$10,549	528	732	48	527	—	12,384
Sales within Phillips	185	306	5	173	40	—	—
Segment sales	\$10,734	834	737	221	567	—	12,384
Operating Profit	\$ 798	345	89	109	50	—	1,391
Total Assets	\$ 7,694	1,193	392	202	445	1,330	11,256
1988							
Sales and Other Operating Revenues							
Outside customers	\$9,673	548	533	55	495	—	11,304
Sales within Phillips	195	199	5	145	48	—	—
Segment sales	\$9,868	747	538	200	543	—	11,304
Operating Profit	\$1,400	343	50	71	105	—	1,969
Total Assets	\$8,046	1,156	388	222	417	1,739	11,968
1987							
Sales and Other Operating Revenues							
Outside customers	\$9,106	520	614	57	424	—	10,721
Sales within Phillips	131	170	4	181	36	—	—
Segment sales	\$9,237	690	618	238	460	—	10,721
Operating Profit	\$ 599	215	90	122	65	—	1,091
Total Assets	\$8,306	1,143	471	246	367	1,578	12,111

*After elimination of intergeographic transactions.

Export sales totaled \$372, \$415 and \$395 million for 1989, 1988 and 1987, respectively.

SELECTED QUARTERLY FINANCIAL DATA

	Millions of Dollars			Net Income (Loss) Per Share of Common Stock
	Sales and Other Operating Revenues	Income (Loss) before Income Taxes	Net Income (Loss)	
1989				
First	\$3,052	277	190	.78
Second	3,264	344	197	.81
Third	3,030	219	87	.36
Fourth	3,038	(304)	(255)	(1.04)
1988				
First	2,863	261	130	.55
Second	2,840	254	170	.72
Third	2,791	334	215	.89
Fourth	2,810	266	135	.55

In 1989, the writedown of offshore California investments decreased fourth quarter income (loss) before income taxes \$423 million and net income (loss) \$280 million (\$1.15 per share).

OIL AND GAS OPERATIONS

Exploration and Production

Capitalized Costs

	At December 31	Millions of Dollars				
		Total	United States	Norway	United Kingdom	Other Areas
1989						
Proved properties	\$8,251	5,116	1,959	594	292	290
Unproved properties	583	436	15	73	16	43
	8,834	5,552	1,974	667	308	333
Accumulated depreciation, depletion and amortization	5,156	3,450	998	405	175	128
	\$3,678	2,102	976	262	133	205
1988						
Proved properties	\$8,166	5,015	1,866	571	457	257
Unproved properties	685	561	9	64	9	42
	8,851	5,576	1,875	635	466	299
Accumulated depreciation, depletion and amortization	4,683	2,945	926	358	331	123
	\$4,168	2,631	949	277	135	176

- Capitalized costs include the cost of equipment and facilities that support only oil and gas producing activities. Not included are investments in U.S. natural gas liquids extraction plants and related systems, as well as downstream manufacturing, distribution and marketing facilities.
- Proved properties include capitalized costs for oil and gas leaseholds holding proved reserves, development wells and related equipment and facilities (including uncompleted development well costs) and support equipment.
- Unproved properties include capitalized costs for oil and gas leaseholds under exploration (including those where petroleum liquids and natural gas were found but not in sufficient quantities to be considered proved reserves) and uncompleted exploratory well costs, including those exploratory wells under evaluation.

■ Costs Incurred

	Millions of Dollars			
	Total	Acquisition	Exploration	Development
1989				
United States	\$326	36	146	144
Norway	110	—	20	90
United Kingdom	54	—	34	20
Africa	37	1	34	2
Other areas	69	9	34	26
	\$596	46	268	282
1988				
United States	\$292	19	101	172
Norway	86	—	11	75
United Kingdom	52	—	30	22
Africa	20	4	10	6
Other areas	37	4	19	14
	\$487	27	171	289
1987				
United States	\$299	28	128	143
Norway	95	—	8	87
United Kingdom	45	—	28	17
Africa	16	—	8	8
Other areas	42	7	31	4
	\$497	35	203	259

- Costs incurred include both capitalized and expensed items.
- Acquisition costs include the costs of acquiring undeveloped oil and gas leaseholds.
- Exploration costs include geological and geophysical expenses, the cost of retaining undeveloped leaseholds, and exploratory drilling costs.

- Development costs include the cost of drilling and equipping development wells and building related production facilities for extracting, treating, gathering and storing petroleum liquids and natural gas.

■ Statistics

Net Production	1989	1988	1987
	Thousands of Barrels Daily		
Crude Oil			
United States	102	110	113
Norway	66	57	46
United Kingdom	16	19	22
Africa	23	25	25
Other areas	11	11	12
	218	222	218
Natural Gas Liquids			
United States†	3	—	—
Norway	12	12	8
	15	12	8

Natural Gas—Wet Basis	Millions of Cubic Feet Daily		
United States (less gas equivalent of liquids shown above)	874	851	772
Norway*	264	259	241
United Kingdom*	71	47	43
Other areas	38	32	30
	1,247	1,189	1,086

*Dry basis.

Average Sales Prices	1989	1988	1987
Crude Oil—Per Barrel			
United States	\$16.60	13.41	16.35
Norway	18.18	14.98	18.26
United Kingdom	18.08	15.25	18.38
Africa	18.24	15.34	18.10
Other areas	12.58	11.29	13.10
Outside United States	17.72	14.77	17.69
Worldwide	17.21	14.11	17.02

Natural Gas Liquids—Per Barrel	1989	1988	1987
United States†	9.33	—	—
Norway	7.87	8.89	8.50

Natural Gas (Lease)—Per Thousand Cubic Feet	1989	1988	1987
United States	1.59	1.53	1.45
Norway	2.28	2.75	3.10
United Kingdom	2.91	2.40	1.63
Other areas	1.27	1.37	1.27
Outside United States	2.30	2.60	2.77
Worldwide	1.84	1.88	1.88

†During 1989, 11 natural gas liquids plants were transferred from Gas and Gas Liquids to Exploration and Production.

Average Production (Lifting) Costs* — Per Equivalent Barrel of Oil	1989	1988	1987
United States	\$4.28	4.34	4.86
Norway	6.59	5.78	10.69
United Kingdom	3.15	2.60	2.18
Africa	2.80	4.50	4.56
Other areas	5.57	4.95	4.53

*Production (lifting) costs consist of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. These costs also include applicable taxes other than income taxes, depreciation of support equipment, cost of retirements, and administrative expenses associated with the production activity. Also included are expenses of \$150 million in 1987 to elevate six platforms offshore Norway; and expenses of \$120 and \$41 million in 1989 and 1988, respectively, to construct a concrete wave barrier to protect a facility offshore Norway. Excluded are depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.

Acreage at December 31, 1989	Thousands of Acres	
	Gross	Net
Developed		
United States	2,567	1,673
Norway	45	17
United Kingdom	22	6
Africa	98	25
Other areas	409	114
	3,141	1,835
Undeveloped		
United States	3,903	2,678
Norway	1,029	383
United Kingdom	1,507	533
Africa	34,926	12,224
Asia	12,210	6,542
Canada	2,057	414
Other areas	1,251	330
	56,883	23,104

Net Wells Completed*	Productive			Dry		
	1989	1988	1987	1989	1988	1987
Exploratory						
United States	8	7	17	16	12	14
Norway	**	**	—	**	—	—
United Kingdom	**	1	—	2	1	—
Africa	1	1	**	—	**	—
Other areas	2	8	6	7	7	8
	11	17	23	25	20	22
Development						
United States	102	138	117	8	12	11
Norway	5	4	**	—	—	—
United Kingdom	1	2	—	1	**	—
Africa	1	1	1	—	**	—
Other areas	5	14	3	—	2	1
	114	159	121	9	14	12

*Excludes farmout arrangements.

**Phillips total proportionate interest in wells completed during the year was less than one.

Wells at Year-End 1989

	In Progress*		Productive**			
	Gross	Net	Oil		Gas	
			Gross	Net	Gross	Net
United States	130	74	31,917	7,195	5,495	2,736
Norway	—	—	102	36	40	11
United Kingdom	34	7	20	7	39	9
Africa	2	1	193	50	11	2
Other areas	7	3	1,086	371	333	94
	173	85	33,318	7,659	5,918	2,852

*Includes wells which have been temporarily suspended.

**Includes 1,525 gross and 649 net multiple completion wells.

Proved Reserves Worldwide

Years Ended December 31	Crude Oil					
	Millions of Barrels					
	United Total	United States	Norway	United Kingdom	Africa	Other Areas
Developed and Undeveloped						
End of 1986	718	355	220	29	83	31
Revisions of previous estimates	76	1	57	6	4	8
Improved recovery	5	4	—	—	—	1
Purchases of reserves in place	1	1	—	—	—	—
Extensions and discoveries	22	13	—	—	3	6
Production	(77)	(40)	(17)	(7)	(9)	(4)
Sales of reserves in place	(1)	(1)	—	—	—	—
End of 1987	744	333	260	28	81	42
Revisions of previous estimates	56	19	29	2	—	6
Improved recovery	47	7	38	—	—	2
Purchases of reserves in place	4	4	—	—	—	—
Extensions and discoveries	11	10	—	—	—	1
Production	(80)	(39)	(21)	(7)	(8)	(5)
Sales of reserves in place	(7)	(7)	—	—	—	—
End of 1988	775	327	306	23	73	46
Revisions of previous estimates	74	15	31	—	30	(2)
Improved recovery	25	5	20	—	—	—
Purchases of reserves in place	1	1	—	—	—	—
Extensions and discoveries	21	18	—	2	—	1
Production	(79)	(37)	(25)	(5)	(9)	(3)
Sales of reserves in place	(1)	(1)	—	—	—	—
End of 1989	816	328	332	20	94	42
Developed						
End of 1986	575	280	176	28	61	30
End of 1987	570	261	188	27	58	36
End of 1988	592	265	214	23	50	40
End of 1989	680	261	267	17	94	41

- Proved reserves are those quantities of crude oil, natural gas and natural gas liquids which, upon analysis of geological and engineering data, appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions. As additional information becomes available or conditions change, estimates must be revised.
- Developed reserves are those portions of proved crude oil, natural gas and natural gas liquids reserves that are recoverable through existing well bores and production equipment and facilities.
- For 1988, 38 million barrels were added as a result of an expanded waterflood project in the Ekofisk field in the Norwegian North Sea. An extension of that project resulted in an additional 20 million barrels being added in 1989.
- In 1989, revisions of previous estimates in Africa are due to an upward revision in Nigeria.

Years Ended December 31	Natural Gas				
	Billions of Cubic Feet				
	Total	United States	Norway	United Kingdom	Other Areas
Developed and Undeveloped					
End of 1986	5,144	3,232	1,313	317	282
Revisions of previous estimates	371	267	132	(33)	5
Extensions and discoveries	185	159	—	7	19
Production	(407)	(281)	(97)	(16)	(13)
Sales of reserves in place	(8)	(8)	—	—	—
End of 1987	5,285	3,369	1,348	275	293
Revisions of previous estimates	449	145	304	19	(19)
Improved recovery	49	—	49	—	—
Purchases of reserves in place	7	7	—	—	—
Extensions and discoveries	177	166	—	—	11
Production	(448)	(312)	(105)	(18)	(13)
Sales of reserves in place	(10)	(10)	—	—	—
End of 1988	5,509	3,365	1,596	276	272
Revisions of previous estimates	33	169	(96)	(26)	(14)
Improved recovery	2	2	—	—	—
Purchases of reserves in place	17	17	—	—	—
Extensions and discoveries	382	358	—	—	24
Production	(468)	(321)	(104)	(27)	(16)
Sales of reserves in place	(5)	(5)	—	—	—
End of 1989	5,470	3,585	1,396	223	266
Developed					
End of 1986	4,548	3,020	1,252	74	202
End of 1987	4,666	3,091	1,286	68	221
End of 1988	4,981	3,086	1,431	256	208
End of 1989	4,883	3,115	1,372	213	183

- Natural gas production quantities may differ from gas production (delivered for sale) as reported on page 43, primarily because the quantities shown above omit the gas equivalent of the liquids, where applicable, but include gas consumed at the lease.
- Natural gas reserves are computed at 14.65 pounds per square inch absolute and 60° Fahrenheit.

Years Ended December 31	Natural Gas Liquids			
	Millions of Barrels			
	Total	United States	Norway	Other Areas
Developed and Undeveloped				
End of 1986	185	141	43	1
Revisions of previous estimates	(6)	(6)	(1)	1
Production	(14)	(11)	(3)	—
End of 1987	165	124	39	2
Revisions of previous estimates	13	4	10	(1)
Improved recovery	2	—	2	—
Extensions and discoveries	4	4	—	—
Production	(15)	(11)	(4)	—
End of 1988	169	121	47	1
Revisions of previous estimates	20	20	(1)	1
Extensions and discoveries	1	1	—	—
Production	(15)	(11)	(4)	—
End of 1989	175	131	42	2
Developed				
End of 1986	183	141	41	1
End of 1987	162	123	37	2
End of 1988	159	118	40	1
End of 1989	167	124	41	2

■ Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities

Amounts are computed using year-end prices and costs (adjusted only for existing contractual changes), appropriate statutory tax rates and a prescribed 10 percent discount factor. Continuation of year-end economic conditions also is assumed. The calculation is based on estimates of proved reserves, which are revised over time as new data becomes available. Probable or possible reserves which may become proved in the future are not considered. The calculation also requires assumptions as to the timing of future production of proved reserves, and the timing and amount of future development and production costs.

While due care was taken in the preparation of this information, the company cautions the reader that this data may not be indicative of the fair market value of the company's oil and gas properties, or a fair estimate of the present value of actual cash flows to be obtained from their development and production.

Discounted Future Net Cash Flows

	Millions of Dollars					
	Total	United States	Norway	United Kingdom	Africa	Other Areas
1989						
Future cash inflows	\$27,857	13,314	10,674	978	1,970	921
Less:						
Future production costs	7,311	4,070	2,369	174	206	492
Future development costs	1,799	1,359	286	114	9	31
Future income tax provisions	9,869	2,229	5,854	343	1,400	43
Future net cash flows	8,878	5,656	2,165	347	355	355
10% annual discount	4,127	2,688	992	85	171	191
Discounted future net cash flows	\$ 4,751	2,968	1,173	262	184	164
1988						
Future cash inflows	\$23,056	10,217	9,572	1,260	1,174	833
Less:						
Future production costs	7,768	3,877	3,171	173	152	395
Future development costs	1,777	944	451	113	88	181
Future income tax provisions	6,749	1,259	4,254	499	737	—
Future net cash flows	6,762	4,137	1,696	475	197	257
10% annual discount	2,975	1,795	810	139	87	144
Discounted future net cash flows	\$ 3,787	2,342	886	336	110	113
1987						
Future cash inflows	\$21,846	9,964	8,599	1,031	1,401	851
Less:						
Future production costs	8,276	4,166	3,342	164	210	394
Future development costs	1,823	1,020	386	107	97	213
Future income tax provisions	5,815	1,129	3,466	350	870	—
Future net cash flows	5,932	3,649	1,405	410	224	244
10% annual discount	2,791	1,700	721	124	91	155
Discounted future net cash flows	\$ 3,141	1,949	684	286	133	89

Sources of Change in Discounted Future Net Cash Flows

	Millions of Dollars		
	1989	1988	1987
Revenues less production costs for the year	\$(1,501)	(1,318)	(1,268)
Net change in prices and production costs for the year	2,711	382	(574)
Extensions, discoveries and improved recovery less estimated future costs	698	478	217
Development costs for the year	282	289	259
Purchases of reserves in place less estimated future costs	21	—	—
Sales of reserves in place less estimated future costs	(4)	(44)	(4)
Revisions of previous quantity estimates and other	(315)	948	114
Accretion of discount	694	569	629
Net change in income taxes	(1,622)	(658)	574
	\$ 964	646	(53)

- The net change in prices and production costs is the beginning of the year reserve production forecast multiplied by the net annual change in the per unit sales price and production cost, discounted at 10 percent.
- Purchases and sales of reserves in place, and extensions, discoveries and improved recovery are production forecasts of the applicable reserve quantities for the year multiplied by the end of the year sales price, less future estimated development and production costs, discounted at 10 percent.
- The accretion of discount is 10 percent of the prior year's discounted future cash inflows less future production and development costs.
- The net change in income taxes is the annual change in the discounted future income tax provisions.

■ Results of Operations

	Millions of Dollars					
	Total	United States	Norway	United Kingdom	Africa	Other Areas
1989						
Sales	\$1,093	557	247	188	34	67
Transfers	1,182	612	454	—	116	—
Total revenues	2,275	1,169	701	188	150	67
Production (lifting) costs	774	391	292	33	24	34
Exploration expenses	422	324*	12	28	28	30
Depreciation, depletion, amortization and retirements	675	537*	75	45	8	10
	404	(83)	322	82	90	(7)
Provision for income taxes	311	(26)	213	29	91	4
Results of operations for producing activities	\$ 93	(57)	109	53	(1)	(11)
1988						
Sales	\$1,073	521	316	148	27	61
Transfers	967	553	310	—	104	—
Total revenues	2,040	1,074	626	148	131	61
Production (lifting) costs	722	390	236	26	41	29
Exploration expenses	315	246	5	19	10	35
Depreciation, depletion, amortization and retirements	529	382	65	51	18	13
	474	56	320	52	62	(16)
Provision for income taxes	278	21	190	18	48	1
Results of operations for producing activities	\$ 196	35	130	34	14	(17)
1987						
Sales	\$1,088	521	322	159	19	67
Transfers	1,060	597	291	15	152	5
Total revenues	2,148	1,118	613	174	171	72
Production (lifting) costs	880	419	367	23	43	28
Exploration expenses	361	294	5	22	5	35
Depreciation, depletion, amortization and retirements	578	445	49	53	14	17
	329	(40)	192	76	109	(8)
Provision for income taxes	211	(15)	116	27	82	1
Results of operations for producing activities	\$ 118	(25)	76	49	27	(9)

*Exploration expenses and depreciation, depletion, amortization and retirements include \$130 and \$183 million, respectively, for the writedown of offshore California investments.

- Results of Operations excludes U.S. natural gas liquids extraction plants and related gas systems, as well as downstream petroleum and chemical activities. In addition, there is no deduction for corporate administrative expenses or interest. Results of operations for producing activities differs from Exploration and Production net income as shown on page 26, primarily because Results of Operations excludes marketing related expenses, gains or losses on sales of assets, foreign currency gains and losses, and equity in earnings from companies which own no hydrocarbon reserves.
- Transfers are valued at prices which approximate market.
- Production (lifting) costs consist of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. These costs also include applicable taxes other than income taxes, depreciation of support equipment, cost of retirements, and administrative expenses associated with the production activity. Also included are expenses of \$150 million in 1987 to elevate six platforms offshore Norway; and expenses of \$120 and \$41 million in 1989 and 1988, respectively, to construct a concrete wave barrier to protect a facility offshore Norway. Excluded are depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.
- Exploration expenses include dry hole, leasehold impairment, geological and geophysical expenses and the cost of retaining undeveloped leaseholds. Also included are applicable taxes other than income taxes, depreciation of support equipment and administrative expenses associated with the exploration activity.
- Depreciation, depletion, amortization and retirements differs from that shown in Analysis of Results by Business Segment on page 41, as cost of retirements and depreciation of support equipment are included with production or exploration expenses as applicable in Results of Operations.
- The provision for income taxes is computed by adjusting each country's income before income taxes for permanent differences related to the oil and gas producing activities that are reflected in the company's consolidated income tax expense for the period and then multiplying the result by the country's statutory tax rate.

FIVE-YEAR FINANCIAL REVIEW

PHILLIPS PETROLEUM COMPANY

Millions of Dollars Except as Indicated

Selected Income Data

Sales and other operating revenues by product

	1989	1988	1987	1986	1985
Crude oil	\$ 3,225	2,717	2,879	2,447	4,881
Natural gas	1,443	1,400	1,348	1,567	2,115
Refined products	4,861	4,258	4,251	3,767	6,001
Chemical products	2,410	2,482	1,878	1,670	2,219
Other sales and services	445	447	365	337	460
Total	12,384	11,304	10,721	9,788	15,676
Net income	219	650	35	228	418

Selected Balance Sheet Data

Current assets	2,876	3,062	2,885	2,802	3,150
Properties, plants and equipment (net)	7,832	8,417	8,772	9,186	10,365
Total assets	11,256	11,968	12,111	12,403	14,052
Current liabilities	2,706	2,468	2,402	2,234	3,114
Long-term debt	3,939	4,761	5,419	5,758	6,548
Deferred income taxes	1,721	1,874	1,705	1,685	1,673
Redeemable preferred stock	—	—	205	270	281
Common stockholders' equity	2,132	2,113	1,617	1,724	1,644

Selected Statement of Cash Flows Data

Net cash provided by operating activities	1,654	1,865	1,162	1,305	1,865
Capital expenditures					
Exploration and Production	451	377	391	339	662
Gas and Gas Liquids	43	37	43	86	133
Petroleum Products	161	177	131	75	94
Chemicals	156	130	78	46	44
Corporate and Other	61	76	94	100	132
Total	872	797	737	646	1,065
Investment purchases	122	59	35	23	—
Dividends paid					
Common	229	157	137	159	542
Preferred	—	11	19	24	12

Other Data

Net income					
As percent of total revenues	1.8%	5.7	.3	2.3	2.6
As percent of average total assets	1.9%	5.4	.3	1.7	2.7
As percent of average common stockholders' equity	9.5%	35.8	2.1	13.5	14.7
Percent of long-term debt to capital	64.9%	69.3	74.8	74.3	77.3
Current ratio	1.1	1.2	1.2	1.3	1.0
Per average common share outstanding					
Net income	\$.90	2.72	.06	.89	1.44
Cash dividends declared	\$.94	.66	.60	.70	.95
Common stockholders' equity per share	\$ 8.74	8.69	7.08	7.55	7.24
Market price per common share					
High	\$ 30.13	22.38	18.75	12.75	17.17
Low	\$ 19.13	12.13	10.00	8.25	11.00
Close	\$ 25.25	19.50	14.00	11.75	12.13
Common shares outstanding at year-end (in millions)	243.9	243.3	228.4	228.3	227.1
Common stockholders at year-end (in thousands)	94.0	96.9	100.1	109.0	83.3
Gross payroll including employee benefits	\$ 1,039	1,053	998	974	1,130
Employees at year-end (in thousands)	21.8	21.0	22.5	21.8	25.3

FIVE-YEAR OPERATING REVIEW

PHILLIPS PETROLEUM COMPANY

Exploration and Production	1989	1988	1987	1986	1985
	Thousands of Barrels Daily				
Net Crude Oil Production					
United States	102	110	113	124	154
Norway	66	57	46	52	63
United Kingdom	16	19	22	23	24
Africa	23	25	25	29	32
Canada	6	5	5	4	4
Southeast Asia	1	2	2	1	—
Latin America	4	4	5	5	4
	218	222	218	238	281

Net Natural Gas Liquids Production					
United States*	3	—	—	—	—
Norway	12	12	8	10	12
	15	12	8	10	12

*During 1989, 11 natural gas liquids plants were transferred from Gas and Gas Liquids to Exploration and Production.

Net Natural Gas Production—Wet Basis	Millions of Cubic Feet Daily				
United States (less gas equivalent of liquids shown above)	874	851	772	820	876
Norway*	264	259	241	217	327
United Kingdom*	71	47	43	54	55
Canada	38	32	30	29	31
Other Europe	—	—	—	—	17
	1,247	1,189	1,086	1,120	1,306

*Dry basis.

Net Oil and Gas Acreage	Millions of Acres				
United States	4	5	5	6	7
Europe	1	1	2	1	1
Africa	12	8	8	2	1
Canada	1	1	1	3	4
Asia	7	5	1	1	2
	25	20	17	13	15

Oil and Gas Wells	Net Wells				
United States					
Oil	7,195	7,292	7,424	7,861	9,077
Gas and condensate	2,736	2,721	2,715	2,749	2,805
Outside United States					
All wells	580	572	552	576	542
	10,511	10,585	10,691	11,186	12,424

Well Completions					
United States					
Exploratory	24	19	31	32	59
Development	110	150	128	92	226
Outside United States					
Exploratory	13	18	14	7	5
Development	13	23	5	8	8
	160	210	178	139	298

Gas and Gas Liquids (United States)	1989	1988	1987	1986	1985
	Millions of Cubic Feet Daily				
Natural Gas Purchases					
Outside Phillips	1,399	1,542	1,602	1,531	1,542
Phillips	393	377	357	395	378
	1,792	1,919	1,959	1,926	1,920

Natural Gas Processed*	1,600	1,859	1,910	2,041	2,160
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*In addition, Exploration and Production processed 94 million cubic feet of natural gas daily in the United States in 1989.

Natural Gas Sales					
Residue gas					
Outside Phillips	1,012	1,034	1,044	1,009	1,044
Phillips	166	138	142	158	146
	1,178	1,172	1,186	1,167	1,190
Liquefied natural gas	99	99	93	96	101
	1,277	1,271	1,279	1,263	1,291

Net Natural Gas Liquids Plant Production*	Thousands of Barrels Daily				
From leasehold gas	28	30	29	36	31
From purchased gas	121	144	145	156	161
	149	174	174	192	192

*In addition, Exploration and Production produced 3 thousand barrels of natural gas liquids daily in the United States in 1989.

Petroleum Products

Refinery Operations					
Crude oil capacity	305	305	305	300	300
Crude oil runs	293	301	302	301	292
Natural gas liquids processing capacity	227	227	223	223	223
Natural gas liquids processed	172	200	195	201	195

Petroleum Products Sold

United States					
Automotive gasoline	277	275	256	243	239
Aviation fuels	34	36	32	31	31
Distillates	95	100	98	93	91
Liquefied petroleum gas	91	95	90	99	108
Other products	38	34	37	47	59
	535	540	513	513	528
Outside United States	53	45	42	41	47
	588	585	555	554	575

Marketing Outlets (in thousands)	10	11	12	12	12
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Chemicals

Selected Outside Sales	Millions of Pounds				
Ethylene	501	720	903	803	812
Polyethylene*	1,541	1,612	1,633	1,410	1,508
Propylene	41	131	120	64	76
Polypropylene	397	402	239	205	175

*U.S. polyethylene production facilities were destroyed by an explosion and fire in October 1989.

BOARD OF DIRECTORS & PRINCIPAL OFFICERS

As of March 1, 1990

Directors

W. Wayne Allen, 53, senior vice president of exploration and production since 1989. Previously, vice president, international exploration and production (1988); general manager of western region exploration and production (1986). Joined Phillips 1961; elected to board 1989.

Norman R. Augustine, 54, chairman of the board and chief executive officer, Martin Marietta Corporation. Lives in Potomac, Md. Elected to Phillips board 1989. Also a director of Riggs National (Bank) Corporation and Procter & Gamble Company. (3), (5)

George B. Beitzel, 61, retired senior vice president and director, International Business Machines Corporation. Lives in Chappaqua, N.Y. Elected to Phillips board 1980. Also a director of Bankers Trust New York Corporation and its subsidiary, Bankers Trust Company; FlightSafety International, Inc.; Roadway Services, Inc.; Rohm and Haas Company; Square D Company; and a member of the advisory board of International Business Machines. (1), (3), (4)

Charles L. Bowerman, 50, senior vice president responsible for petroleum products since 1988. Previously, vice president of marketing (1984); marketing operations manager (1982). Joined Phillips 1961; elected to board 1989.

Glenn A. Cox, 60, president and chief operating officer since 1985. Previously, executive vice president (1980); vice president, management information and control (1974). Joined Phillips 1956; elected to board 1982. Also a director of BancOklahoma Corp. (1)

James B. Edwards, 62, president of the Medical University of South Carolina; former U.S. secretary of energy and former governor of South Carolina. Lives in Mount Pleasant, S.C. Elected to Phillips board 1983. Also a director of The South Carolina National Corporation and its subsidiary, The South Carolina National Bank; Brendle's, Inc.; SCANA Corporation; Chemical Waste Management, Inc.; Imo Industries Inc.; Encyclopaedia Britannica, Inc.; and National Data Corporation. (1), (2), (3)

Robert F. Froehlke, 67, president and chief executive officer and director of IDS Mutual Fund Group; former chairman of the board, The Equitable Life Assurance Society of the United States. Lives in Minneapolis, Minn. Elected to Phillips board 1984. Also a director of Square D Company and the Public Oversight Board of the American Institute of Certified Public Accountants. Also chairman of the Institute for Defense Analysis. (2), (5)

E. Douglas Kenna, 65, chairman of the board of directors, Carlisle Companies, Inc. Lives in N. Palm Beach, Fla. Elected to Phillips board 1977. Also a director of Burnley Corporation; Fleet/Norstar Financial Group; Harrow Corporation; and Heritage Media, Inc. (1), (2), (4)

Melvin R. Laird, 67, senior counsellor for national and international affairs, The Reader's Digest Association, Inc.; former nine-term U.S. congressman; secretary of defense and presidential counsellor. Lives in Bethesda, Md. Elected to Phillips board 1976. Also a director of Northwest Airlines, Inc.; Metropolitan Life Insurance Company; Science Applications International Corporation; Communications Satellite Corporation; Martin Marietta Corporation; IDS Mutual Fund Group; and the Public Oversight Board of the American Institute of Certified Public Accountants. (4), (5)

C. J. (Pete) Silas, 57, chairman of the board of directors and chief executive officer since 1985. Previously, president and chief operating officer (1982); executive vice president (1980). Joined Phillips 1953; elected to board 1982. Also a director of The First National Bank and Trust Company of Tulsa. (1)

Bill M. Thompson, 57, executive vice president, responsible for Phillips' downstream businesses, since 1988. Previously, senior vice president, planning and technology (1986); vice president, corporate planning and development (1983). Joined Phillips 1954; elected to board 1988.

David J. Tippeconnic, 50, senior vice president responsible for planning and technology since 1988. Previously, vice president of human resources and services (1986); general manager of Sweeny refinery (1981). Joined Phillips 1961; elected to board 1989.

W. Clarke Wescoe, 69, retired chairman of the board of directors, Sterling Drug Inc.; former chancellor, University of Kansas. Lives in Minneapolis, Minn. Elected to Phillips board 1963. Also a director of The New York Stock Exchange. (2), (3)

Dolores D. Wharton, 62, president of The Fund for Corporate Initiatives, Inc., a nonprofit organization devoted to strengthening the role of minorities and women in the corporate world. Lives in New York, N.Y. Elected to Phillips board 1976. Also a director of Gannett Co., Inc.; and Kellogg Company. (3), (5)

Francis M. Wheat, 69, advisory partner and former senior partner, law firm of Gibson, Dunn & Crutcher. Lives in Los Angeles, Calif. Elected to Phillips board 1976. (2), (5)

- (1) Member Executive Committee
- (2) Member Audit Committee
- (3) Member Compensation Committee
- (4) Member Nominating Committee
- (5) Member Public Policy Committee

MANAGEMENT & DIRECTOR CHANGES

Officers

C. J. (Pete) Silas, Chairman of the Board of Directors and Chief Executive Officer
Glenn A. Cox, President and Chief Operating Officer
Bill M. Thompson, Executive Vice President
W. Wayne Allen, Senior Vice President Exploration and Production
Charles L. Bowerman, Senior Vice President Petroleum Products
William G. Paul, Senior Vice President and General Counsel
Ken L. Smalley, Senior Vice President
David J. Tippeconnic, Senior Vice President

Other Corporate Officers

Charles F. Cook, Vice President
Lavele L. Frantz, Vice President Human Resources and Services
F. Ben Jones, Vice President Research and Development
John C. Mihm, Vice President Corporate Engineering
James J. Mulva, Vice President, Treasurer and Chief Financial Officer
Joe W. O'Toole, Vice President and General Tax Officer
Richard I. Robinson, Vice President Refining
Ted L. Sandridge, Vice President International Exploration and Production
John N. Scott, Vice President Quality, Environment and Safety
Ray G. Steiner, Vice President Supply and Transportation
John R. VanBuskirk, Vice President Plastics
John L. Whitmire, Vice President North America Exploration and Production
J. Bryan Whitworth, Vice President Corporate Affairs
Charles L. Wyndham, Vice President Exploration
James A. Kelly, Comptroller
Lewis E. Burnham, General Auditor
George C. Meese, Secretary
Leonard F. Francis, Assistant General Tax Officer
David W. Casselberry, Assistant Treasurer
Larry L. McCall, Assistant Treasurer
Joe M. McKee, Assistant Treasurer
M. Richard Schmutz, Assistant Comptroller
Jerry G. Wilson, Assistant Comptroller
Donald L. Cone, Assistant Secretary
Terry B. Nance, Assistant Secretary

The following changes were effective March 1, 1990:

- **F. Ben Jones**, formerly downstream planning and budgeting manager, was elected vice president of research and development, replacing **Charles F. Cook**, who will be on special assignment until reaching normal retirement age at year-end. Cook will retire with some 32 years' service. Jones, 57, joined Phillips in 1964.
- **James J. Mulva**, vice president and treasurer, was elected chief financial officer, assuming responsibilities formerly held by **R. E. (Gene) Bonnell**. Bonnell, senior vice president of finance, took early retirement March 1, 1990, after more than 33 years' service.

These changes took effect in 1989:

- **W. Wayne Allen**, **Charles L. Bowerman** and **David J. Tippeconnic**, senior vice presidents of Phillips, were elected to the company's board of directors December 11, 1989.
- **Len M. Rickards**, director and executive vice president responsible for upstream operations, retired September 1, 1989, after 39 years' service.
- **W. Wayne Allen**, formerly vice president of international exploration and production, was named senior vice president of exploration and production.
- **Ted L. Sandridge**, formerly managing director of the United Kingdom division of exploration and production, replaced Allen as vice president of international exploration and production. Sandridge, 53, joined Phillips in 1959.
- **John N. Scott**, formerly chairman and chief executive officer of Incinatrol, Inc., a Phillips affiliate, was named vice president of quality, environment and safety. Scott, 59, joined Phillips in 1952.

STOCKHOLDER INFORMATION

Annual Meeting

Phillips' annual meeting of stockholders will be held at the following time and place:

May 14, 1990; 10:00 a.m.
Stouffer Waverly Hotel
2450 Galleria Parkway NW
Atlanta, Ga.

Notice of the meeting and proxy material are being sent to all stockholders.

Dividend Reinvestment Plan

Phillips' dividend reinvestment plan enables shareholders to buy additional shares with their common stock dividends. Participants also may make commission-free purchases of company stock through direct cash payment. Contact Stockholder Records in Bartlesville for details.

Information Requests

The company welcomes your comments about its operations or any aspect of its business. Write to one of the addresses below, or contact any of the following:

- Investor Relations in New York City (212/397-9766).
- Financial Communications in Bartlesville (918/661-5126).

Questions about stockholder matters such as dividends, certificates, dividend reinvestment plan or electronic deposit of security payments should be directed to the stockholder records section in Bartlesville.

- Call toll-free, 1-800-356-0066 (in Oklahoma, 1-800-722-0660).
- Or write Stockholder Records in care of the company's Bartlesville address.

Form 10-K

Copies of the Phillips Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, are available without charge by writing to Office of the Secretary in Bartlesville.

Annual Contributions Report

Copies of the company's annual contributions report are also available without charge by writing to Office of the Secretary.

Principal Offices

Bartlesville, Okla. 74004

630 Fifth Avenue
New York, N.Y. 10111

306 S. State Street
Dover, Del. 19901

Stock Transfer Offices

Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

Montreal Trust Company
15 King Street West
Toronto, Ontario
Canada M5H 1B4

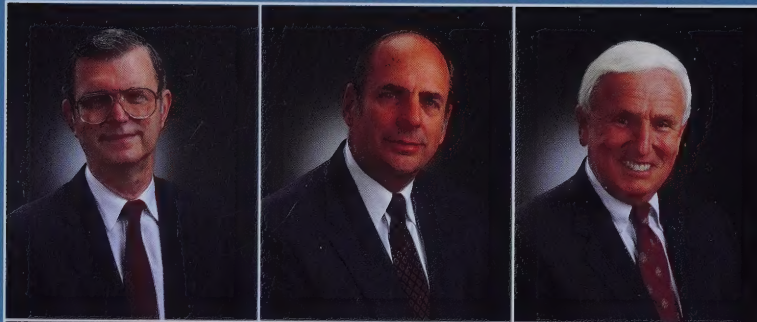
Registrars

Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

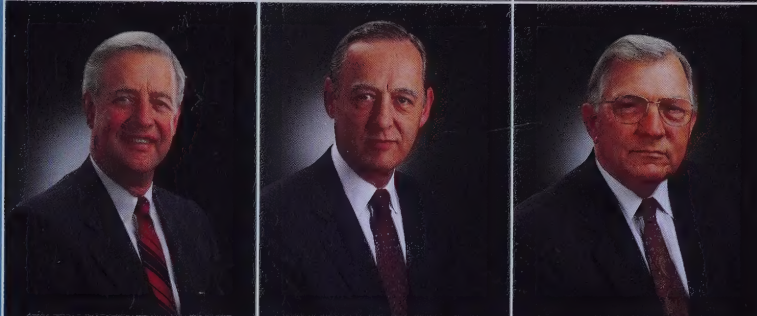
Montreal Trust Company
66 Temperance Street
Toronto, Ontario
Canada M5H 1Y7

Board of Directors

*W. Wayne Allen
Norman R. Augustine
George B. Beitzel*



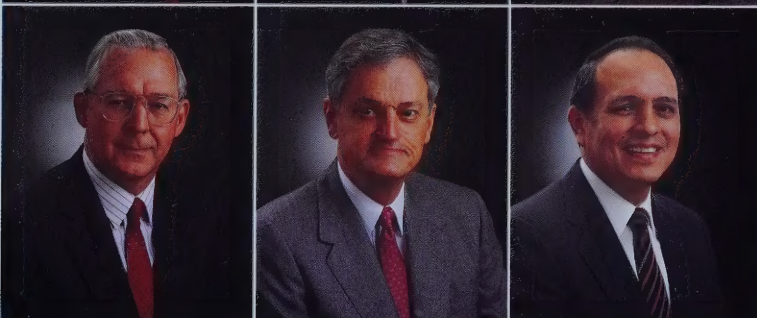
*Charles L. Bowerman
Glenn A. Cox
James B. Edwards*



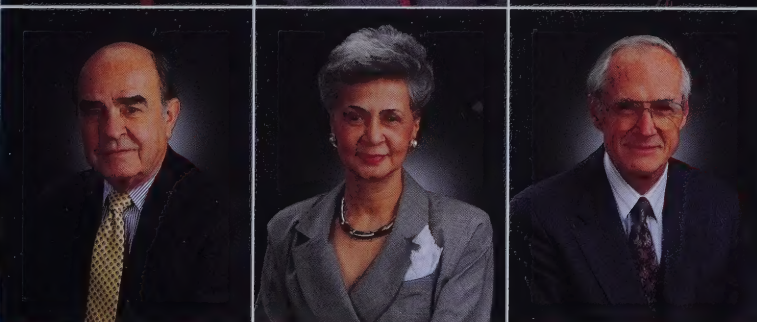
*Robert F. Froehlke
E. Douglas Kenna
Melvin R. Laird*



*C. J. Silas
Bill M. Thompson
David J. Tippeconnic*



*W. Clarke Wescoe
Dolores D. Wharton
Francis M. Wheat*





PHILLIPS PETROLEUM COMPANY
BARTLESVILLE, OKLAHOMA 74004

Bulk Rate
U.S. Postage
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Phillips Petroleum
Company

